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NAFCU CREDIT UNION COMPLIANCE ROADMAP

Your Companion for Navigating Federal Credit Union Regulations

National Association of Federally-Insured Credit Unions

Official textbook for our award-winning NAFCU Certified Compliance Officer (NCCO) Designation

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WELCOME TO NAFCU'S CREDIT UNION COMPLIANCE ROADMAP.

The *Roadmap* is designed to to assist credit union professionals as they navigate a complex regulatory environment. The *Roadmap* is a research tool for credit unions that focuses on federal regulatory requirements. It will be helpful to anyone who wants to gain a solid foundation of knowledge about the federal compliance issues facing credit unions. As a daily resource guide, this manual is designed to be used electronically with links to federal laws, regulations, guidance documents and other helpful resources.

The *Roadmap* also serves as the textbook for NAFCU's Regulatory Compliance School conference as well as for individuals following the On-Demand Compliance School program.

The *Roadmap* contains tools to help credit unions find answers to their own questions. These include:

› **NAFCU Notes –** links to relevant NAFCU resources such as Compliance Blog posts and Compliance Monitor articles;
› **Research Tips –** suggestions on conducting research and links to regulatory resources to assist users in making a deeper dive on a particular topic;
› **Examples –** illustrations of a concept to contexualize a rule or issue; and
› **More Information –** other helpful information such as compliance tips, cross-references to another area of the Roadmap that may be helpful, common issues and other insights.

We want to be clear about what this manual *is not.* The *Roadmap* is not an attempt to address every nuance of every law, regulation and guidance document that affects credit unions. Rather, we wanted to highlight major topics and give you the resources and tools so that *you* can research the topics. Our goal was not to give you everything, but to empower you so that you can find anything that you need.

If you are studying for your NCCO designation, this manual is your best study guide. There are four NCCO exams in total – each testing on information found specifically within this manual.

Finally, we want to say thanks. You either purchased this, your credit union did, or someone from your credit union attended NAFCU's Regulatory Compliance School. *We appreciate that fact*. If we can improve this manual, just let us know.

NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS

Founded in 1967, the National Association of Federally-Insured Credit Unions (NAFCU) advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 132 million consumers with personal and small business financial service products. The association supports a regulatory environment that allows credit unions to grow with a focus on directly shaping the laws and regulations under which federally-insured credit unions operate.

NAFCU provides regulatory compliance assistance to its member-credit unions through a multi-faceted program, including direct access to the association's compliance and regulatory affairs divisions. For more information on NAFCU compliance resources, please visit our compliance homepage.

REGULATORY COMPLIANCE DIVISION

Nick St. John, NCCO, NCBSO is NAFCU's Director of Regulatory Compliance and is responsible for all aspects of the association's multi-faceted compliance assistance program – including answering compliance questions, authoring compliance blog posts and articles as well as speaking at credit union events. Additionally, he oversees all of NAFCU's compliance-related products and services.

Prior to joining NAFCU, Nick managed Banking & Finance content for Bloomberg Law, where he analyzed legal developments relating to FinTech, CFPB regulatory and enforcement actions, and state legislation. He is a graduate of The University of Georgia School of Law, and has a bachelor's degree from CUNY John Jay College.

Rebecaa Tetreau, NCCO was named Senior Regulatory Compliance Counsel in August 2022. In this role, Rebecca helps credit unions with a variety of federal regulatory compliance issues. She initially joined NAFCU as regulatory compliance counsel in February 2021.

Prior to joining NAFCU, Rebecca was the Regulatory Change Manager for Quicken Loans, where she managed and reviewed all incoming state and federal legislative and regulatory changes affecting the company, from proposed status through enactment. She is a graduate of the University of the District of Columbia – David A. Clarke School of Law and has a bachelor's degree from Eastern Michigan University.

Keith Schostag, NCCO was named Senior Regulatory Compliance Counsel in August 2022. In this role, Keith assists credit unions with a variety of compliance issues. Keith joined NAFCU as regulatory compliance counsel in February 2021.

Prior to joining NAFCU, Keith worked as a creditor's rights attorney. Keith worked with and advised clients on issues such as collections, repossession, and bankruptcy. Keith is a graduate of the UCLA School of Law and has a bachelor's degree from California Polytechnic University at San Luis Obispo.

Justin White, NCCO joined NAFCU as a regulatory compliance counsel in August 2021. As part of the Regulatory Compliance Team, he provides daily compliance assistance to member credit unions on a variety of topics.

Prior to joining NAFCU, Justin worked at another financial services trade association where he provided in-house legal support and tracked litigation issues related to the financial services industry. He is a graduate of Suffolk University Law School and has a bachelor's degree from Hobart and William Smith Colleges.

JaMonika Williams, NCCO joined NAFCU as a regulatory compliance counsel in July 2022. In this role, JaMonika assists credit unions with a variety of compliance issues.

Prior to joining NAFCU, JaMonika worked as a Virginia prosecutor. JaMonika also has experience as in-house counsel for a federal credit union, where she worked with and advised her client on issues such as collections, repossessions, and bankruptcy. JaMonika is a graduate of the Elon University School of Law and has a bachelor's degree from The College of William & Mary.

Tara Simpson, NCCO joined NAFCU as a regulatory compliance counsel in July 2022. In this role, Tara assists credit unions with a variety of compliance issues.

Prior to joining NAFCU, Tara was the Legal Change Manager for Rocket Mortgage, where she reviewed and managed all incoming state and federal legislative and regulatory changes affecting the company. Tara also has experience reviewing contracts. She is a graduate of the University of Toledo College of Law and has two bachelor's degrees from the University of Michigan-Dearborn.

REGULATION LINKS

Recognizing that links break and/or change at times, below is a list of links to regulation main webpages to assist with research and to access regulations discussed throughout this manual. This is *not* intended to be a complete list of all regulations impacting the credit union industry.

Consumer Financial Protection Bureau (CFPB)

Title 12, Chapter X

Regulation B (Equal Credit Opportunity Act) Part 1002
Regulation C (Home Mortgage Disclosure Act) Part 1003
Regulation E (Electronic Fund Transfers) Part 1005
Regulation F (Debt Collection Practices) Part 1006
Regulation G (S.A.F.E. Mortgage Licensing Act – Federal Registration of Residential Mortgage Loan Originators) Part 1007
Regulation H (S.A.F.E. Mortgage Licensing Act - State Compliance and Bureau Registration System) Part 1008
Regulation P (Privacy of Consumer Financial Information) Part 1016
Regulation V (Fair Credit Reporting Act) Part 1022
Regulation X (Real Estate Settlement Procedures Act) Part 1024
Regulation Z (Truth in Lending Act) Part 1026
Payday, Vehicle Title and Certain High-Cost Installment Loans Part 1041

Department of Defense (DoD)

Title 32, Chapter I, Subtitle A (Military Lending Act) Part 232

Department of Justice (DoJ)

Title 28, Chapter I (Americans with Disabilities Act) Part 36

Federal Communications Commission

Title 47, Chapter I, Subchapter B, Subpart L (Telephone Consumer Protection Act) Part 64

Federal Reserve System

Title 12, Chapters II

Regulation D (Reserve Requirements of Depository Institutions) Part 204

Regulation CC (Availability of Funds and Collection of Checks) Part 229

Regulation J (Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire) Part 210

Regulation GG (Prohibition on Funding of Unlawful Internet Gambling) Part 233

Financial Crimes Enforcement Network (FinCEN)

Title 31, Chapter X

Bank Secrecy Act Regulations

General Provisions – Part 1010

Rule for Banks – Part 1020

National Credit Union Administration (NCUA)

Title 12, Chapter VII

Subchapter A – Regulations Affecting Credit Unions Parts 700-761

Office of Foreign Assets Control (OFAC)

Title 31, Chapter V

Subtitle B – Regulations– Part 500

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CHAPTER 1

Fundamentals

CHAPTER 1 — FUNDAMENTALS

SECTION 1 — THE LEGISLATIVE AND REGULATORY PROCESS

LEGISLATIVE PROCESS

I'm Just a Bill

Every public law started out as a bill or resolution in Congress, which are simply proposed legislation. In the Senate, bills are numbered and prefaced with the letter S. (i.e., S. 145); in the House, they are prefaced with the letters H.R. (i.e., H.R. 145). Legislative proposals are introduced in the respective chambers by Senators or Representatives – the Senator or Representative that introduces a bill becomes its "sponsor." Once a bill is introduced into the House or Senate, it is usually referred to the committee that has jurisdiction over the subject of the proposal.

RESEARCH TIP: Congress.gov is a great resource for researching bills and other activity in Congress. It is a website run by the Library of Congress that tracks federal legislation and makes the information available to the public.

Committees

The Senate and the House of Representatives have several committees that preside over specific subject matters. Both political parties have members on each committee; the chair of the committee will be a member of the majority party. These committees are broken down further into subcommittees, which preside over more specific subject areas. For example, the Senate Committee on Banking, Housing, and Urban Affairs oversees many subject areas such as banking, securities, housing and mass transit. It has five subcommittees that specialize in a smaller portion of the committee's jurisdiction: Economic Policy; Financial Institutions and Consumer Protection; Housing, Transportation and Community Development; National Security and International Trade and Finance; and Securities, Insurance and Investment. The House of Representatives has a Financial Services Committee, which oversees "the Federal Reserve Board and individual reserve banks, the Treasury, the production and distribution of currency, and the Nation's capital markets."

Once a bill makes it to committee, the committee will determine whether or not to take it up for consideration. Many bills are introduced but not every bill will be considered. A committee, therefore, has considerable power in setting the House and Senate agendas by determining which bills it will consider in detail. When a bill is under consideration, the committee will request input from relevant government agencies and departments, often in the form of a report. Committees often hold hearings to gather more information, especially if the committee views the bill as significant. These hearings generally have expert witnesses, who may be from government agencies or the industry the bill purports to govern; and impartial witnesses that have an expertise in the subject at hand.

After hearings are completed, the committee will deliberate the bill and members often introduce amendments in what is referred to as the "markup" phase. The committee members vote on the changes and for further action of the measure. If the committee votes to report the bill, the Committee Report is produced, and then the bill is introduced to the floor for debate.

NAFCU NOTE

NAFCU often sends credit union witnesses before a committee that is considering a bill that could affect credit unions. For example, on April 10, 2019, the VP of Business Services and Operations at Kinecta Federal Credit Union testified before the House Small Business Subcommittee on Economic Growth, Tax and Capital Access on "SBA 7(a) Budget Proposal and the Impact of Fee Structure Changes." This and other **NAFCU testimony may be reviewed on NAFCU's website**.

Floor Consideration

Once a bill is brought to the floor of the House or Senate it may be debated by the full membership. The bill is then ready for the vote on passage. If the bill is passed by the House of Representatives and a Senate version has yet to be passed, the House's version will be referred to the Senate, and vice versa. Once a version has been passed by both houses, it will go to the president.

The president can either sign or veto the bill. If the president vetoes the bill, Congress can redraft it or override the veto with a two-thirds vote in both the House and Senate. If the president does nothing with the bill for 10 days, it automatically becomes law. Normally, once a bill reaches the president, it is signed into law.

Some of these laws, usually referred to as "Acts", are self-effectuating, meaning regulations are not needed to interpret the act or "bring it into effect." Other laws direct an agency (or several agencies) to issue implementing regulations to interpret and carry out an act's requirements.

EXAMPLE

The E-SIGN Act is an example of a self-effectuating act. All the requirements a credit union must follow to provide electronic disclosures to members are found directly in the E-SIGN Act itself.

The Importance of Legislation

Why do we care about the legislative process and which committees oversee areas that govern credit unions? We care because once a law is on the books, it is very hard to change. Any influence the credit union community can exert must begin before the law is enacted. Once it is on the books, credit unions may have some influence in the outcome of the implementing regulations. But the agencies only have so much flexibility in interpreting and implementing the statutes – they must follow the law. Every credit union should know its respective senators and representatives and which committees they serve.

REGULATORY PROCESS

Federal regulations are implemented by federal agencies. These agencies, such as the National Credit Union Administration (NCUA), issue regulations under specific direction from an act or from an agency's general authority to issue regulations to interpret and carry out an act.

Section 1766 of the Federal Credit Union Act provides in part: "the Board may prescribe rules and regulations for the administration of this chapter (including, but not by way of limitation, the merger, consolidation, and dissolution of corporations organized under this chapter)." The NCUA Board is the "Board" referred to in this section. Thus, the NCUA Board may prescribe rules as it sees fit to carry out the purpose of the Federal Credit Union Act.

Acts may also specifically direct an agency or agencies to issue implementing regulations. For example, the regulations found in Part 707 of NCUA's regulations exist because the Truth in Savings Act directed NCUA, along with the federal banking agencies, to issue implementing regulations to carry out specific provisions of the Act.

Proposed Rules

NCUA and the other agencies cannot simply adopt new regulations. Under the Administrative Procedure Act (APA), they must follow specific procedures, which generally include issuing proposed rules and giving the public time to provide comments on these proposals. Any interested party may comment on a proposed rule, and this is the best time for the credit union industry to provide its views on a specific proposal. Comments are made public and can be accessed from the particular agency's website. NCUA, for example, has a specific webpage listing proposed rules with respective comments. The agency is required to consider all submitted comments when formulating the final rule.

NAFCU NOTE

NAFCU provides comments on proposed rules and seeks comments from member credit unions through publications called Regulatory Alerts. The alerts summarize the proposed rule and seek comment on specific issues. A NAFCU member credit union may issue comments to NAFCU for the association's comment letter and may provide its own comment letters directly to the agency that issued the proposed rule.

Final Rules

Final rules are issued after the comment period is over and the agency has had enough time to consider all comments. When the final rule is issued, it usually includes a summary, a background section, an in-depth discussion of the comments and the agency's determination of the final rule, as well as the final rule. The in-depth discussion contains the agency's rationale for the final rule. To know what an agency was thinking in formulating a final rule, look to the in-depth discussion. This is often called the preamble or prefatory language.

The final rule will have one or two dates – the effective date and perhaps a mandatory compliance date. If the rule has a mandatory compliance date, it is generally further out than the effective date. A mandatory compliance date may be provided when the agency is aware that the industry needs extra time to come into compliance because credit unions must change internal procedures or amend disclosures. If there is not a mandatory compliance date, the credit union is expected to be in compliance by the effective date.

EXAMPLE

Credit unions can comment on which regulations need to be updated, the unintended consequences of certain regulatory requirements and other issues that may restrict how the credit union provides its members with the products and services they demand.

Agencies will conduct regulatory reviews, where existing regulations are reviewed to determine if updates are necessary. NCUA identifies one-third of its regulations for review every year (each regulation is under review every three years). NCUA notifies the public of its annual regulatory review, identifying the regulations that are up for review. The public may then make any comments regarding those regulations. This is a rare opportunity to comment on regulations that have already been implemented.

Advanced Notice of Proposed Rulemaking

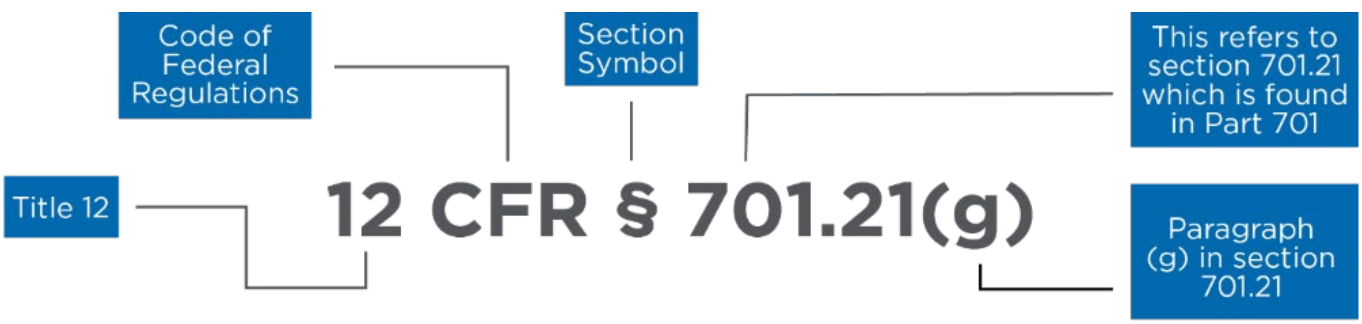
An advanced notice of proposed rulemaking (ANPR) is used when an agency feels it needs more information about a topic before it issues a proposed rule or to help determine if a rulemaking is necessary.

Interim Final Rule

The APA provides an exception to the public notice and comment prior to promulgation of a rule when an agency "for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rule issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." *See*, 5 USC § 553(b)(3)(B). When an agency has such a finding, it will issue an interim final rule. The interim final rule is issued, along with a request for public comments. The agency may issue a final rule after considering public comments, but in the meantime, there is a final rule in effect. These are seldom used by the financial services regulatory agencies but are issued occasionally in emergency situations and when the agency has little flexibility from the statute.

ANATOMY OF A REGULATION

Understanding the makeup of a regulation is conducive to effective compliance research. This section details the anatomy of a regulation, but the best way to get familiar with regulatory research is with practice. Here is an example from NCUA's Truth in Savings rule to illustrate how a regulation is structured.



Code of Federal Regulations

Federal regulations are created by federal agencies, such as NCUA and the Bureau of Consumer Financial Protection (CFPB). These regulations are codified in the Code of Federal Regulations (CFR). The regulations are indexed by titles, chapters, parts and sections. Titles are categorized by subject matter. For example, the subject matter for Title 12 of the CFR is Banks and Banking. Title 12 houses most (but not all) of the federal regulations governing credit unions. NCUA's regulations are housed in Title 12, Chapter VII. Parts 700-799 are dedicated to NCUA regulations. Within each part are sections. For example, Part 701 houses NCUA's rules for the organization and operation of federal credit unions, and section 701.21 provides NCUA's general lending regulations for federal credit unions. When an article cites to the CFR, the citation is providing the specific regulation or section on which the author is relying.

All the CFR regulations are on the Code of Federal Regulations website and also on the e-CFR site (electronic CFR). The various agencies will generally provide their specific regulations on the agency websites. For example, NCUA makes its regulations available here. If you are searching for a recent final rule, NCUA houses these on a different page entitled Rulemakings and Proposals for Comment.

The Rule Itself

Regulations tend to have the same general makeup:

- **Authority/Purpose/Scope Section.** This section generally provides the authority of the agency to promulgate the rule, the purpose of the rule and the scope/coverage of the rule.
- **Definitions Section.** This section defines terms used throughout the rule. Do not ignore this section, as it can define a generally understood term to mean something very specific that might not be expected. The credit union's responsibility, and an answer to a compliance question, can turn on a definition specific to that section.

EXAMPLE

Most people have a general understanding of the term "downpayment" in reference to a credit transaction. However, Regulation Z defines this term to mean something very specific – the amount paid to a seller to reduce the cash price of goods or services in a transaction where the seller is also the creditor.

- **Substantive Rules.** These sections provide the substantive rules that set forth the responsibilities and potential liabilities of the credit union.
- **Recordkeeping.** Many regulations have recordkeeping requirements.
- **Enforcement.** Enforcement authority of a regulation is often spelled out in a separate section of the rule.

- **Appendices.** These can contain sample forms and disclosures, staff commentary and other explanatory information.

Some regulations are so large they are divided into subparts (Regulation Z has Subparts A-G). These subparts generally are a group of sections related by a common subject (one of Regulation Z's subparts relates to open-end lending, another to closed-end lending, etc.). All regulations have sections that have a title and a specific number linked to them (Section 1026.2 of Regulation Z is titled "Definitions and rules of construction."). The section titles can be useful. When reviewing an advertisement for a checking account, you might look at the Truth in Savings section, appropriately titled "Advertising," which houses the rules for advertisements of accounts.

Staff Commentary

Not every rule has staff commentary, but when a rule does have one it can be very helpful. Staff commentary is often found as an appendix or supplement to a rule, rather than in a numbered section. The staff commentary tends to provide explanations and examples of the rules in plain English. If you are unclear as to the application of a rule after reading it, the next step is to review the staff commentary.

Preambles

Preambles, or prefatory language, are found in the official proposed rule or final rule issued in the *Federal Register*. This language contains background information, summaries, explanations of the agency's determinations and, in final rules, summaries of comments received by the agency.

EXAMPLE

For an example of what the Federal Register version looks like, NCUA's 2019 revision to the flood insurance rules can be found in PDF here or electronically here.

RESEARCH TIP: The preamble **is a great place to head when researching a question that seems to be stuck in the "gray" area that the rule and staff commentary do not answer. An answer may or may not be found here but it often gives an indication as to what the agency's goal was with a particular provision. The preamble could also indicate what an agency's response might be to a specific question if posed directly to that agency.**

You will not find the preamble in the codified rule; it can only be found in the *Federal Register* issue that contains the rules. When a federal agency such as the NCUA issues a final rule, the rule is published in the Federal Register. This publication will contain the entire rule, including the preamble. An agency will often post this version of a rule on its own website as well, but they do not remain there forever. The *Federal Register* can be researched online as far back as 1995.

Legal Opinion Letters

Legal opinion letters, or staff opinion letters, are letters written by an agency that has authority to interpret the regulation at hand. Such letters are not part of a regulation, but often interpret the application of a regulation to a specific set of facts. Not all federal regulators issue legal opinions, but NCUA does and has many of its legal opinion letters listed on its website. The letters are responses to questions posed by an individual or entity. Many of NCUA's legal opinion letters are addressed to credit unions or attorneys working for credit unions. Technically, these legal opinion letters apply only to the question at hand and to the party that posed the question. However, they are incredibly useful research tools. If an agency has addressed your question, or one similar to it, in a previously written legal opinion letter, it provides a good indication of how the agency would respond to your specific question. It is important to keep in mind that these letters can be superseded by subsequent opinion letters or regulations. So, when coming across a letter that addresses an issue you are researching, dig a little further to ensure that the opinion has not been replaced. The older the letter, the more susceptible the opinion is to being outdated.

Other Guidance

NCUA issues guidance that may or may not go through the formal rulemaking process. The agency issues Interpretive Rulings and Policy Statements (IRPS) that are NCUA's official interpretation of the Federal Credit Union Act (FCU Act) as it relates to a particular issue. NCUA also issues Letters to Credit Unions and Other Guidance These letters address policy issues and are frequently used to clarify NCUA exam expectations or other operational issues for federally insured credit unions and federal credit unions, respectively.

In addition, NCUA issues Regulatory Alerts to notify credit unions of changes to regulations. The agency typically issues an alert when a law or regulation issued by another regulator would impact credit unions. In general, these alerts are not timely enough to assist credit unions in preparing for regulatory change. Similarly, NCUA will occasionally issue a Risk Alert to notify credit unions of a particular risk that could impact a credit union's operation. The Letters to Credit Unions, Letters to Federal Credit Unions, Risk Alerts and Regulatory Alerts can be accessed here.

All of these guidance documents may be found on NCUA's website. One should always look at the date of a piece of guidance and check to see if anything more recent has been issued. NCUA's IRPS webpage only includes links to active IRPS. With Letters to Credit Unions, NCUA no longer includes obsolete letters on its website.

Putting it All Together

As mentioned before, NCUA's rules and regulations are officially codified in the Code of Federal Regulation at 12 CFR Parts 700-799. NCUA promulgates the rules that appear in the CFR with notice and comment rulemaking as set out in the Administrative Procedure Act. This means a rulemaking may have three or four stages. There may be an advance notice of proposed rulemaking where the agency seeks broad comments on a group of general ideas it wants to draft a rule about. Many times, NCUA goes directly to the proposed rule stage and publishes a proposed rule in the *Federal Register* for the public to comment on. Once the agency has comments, it may then issue a final rule. The agency may also issue an interim final rule, which is effective while the agency receives comments. This is often done when the rule is an emergency type of rule or if the agency has little flexibility pursuant to a statute.

Multiple federal regulators issue regulations that give credit unions specific rules to follow that flow from the authority in various statutes. An agency's regulations also provide specific rules to follow regarding the agency's adjudicatory powers and rules regarding access to information.

RESEARCH TIP: Go to the ***Federal Register*** website to start browsing, to sign up for the daily email of its Table of Contents or sign up to be notified each time a rule impacting credit unions is published in the *Federal Register* by creating a search and subscribing to those results. See this NAFCU *Compliance Blog* post for more details.

CHAPTER 1 – FUNDAMENTALS

SECTION 2 — THE FEDERAL CREDIT UNION ACT AND THE NATIONAL CREDIT UNION ADMINISTRATION

OVERVIEW OF THE FEDERAL CREDIT UNION ACT

Federal credit unions are chartered under the Federal Credit Union Act (FCU Act). The FCU Act creates the main body of law under which federal credit unions are governed and sets forth the National Credit Union Administration's (NCUA) authority to perform functions like overseeing the share insurance fund. Of course, credit unions are required to comply with additional laws and regulations. This section will focus solely on the FCU Act and its implementation by the NCUA. State chartered credit unions should look to their state credit union act to determine the applicable rules.

HISTORY OF THE FEDERAL CREDIT UNION ACT

During the Great Depression, banks refused to provide loans to community members, especially those who were poor. Due to this, credit unions were formed by groups of people pooling their savings and making loans to neighbors to provide a source of inexpensive credit to purchase products. As the popularity of credit unions grew and more states adopted legislation to form state charted credit unions, it became necessary for federal credit unions to be formed. The FCU Act was enacted by Congress in 1934.

As the FCU Act congressional findings explain, credit unions are unlike banks because "they are member-owned, democratically operated, not for profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means." The purpose of the law was to make credit available and promote provident credit through a national system of not-for-profit cooperative credit unions. The FCU Act established the federal credit union system and created the Bureau of Credit Unions, the predecessor to the NCUA, to charter and oversee federal credit unions.

Major Provisions

Title I - General Provisions

Title I establishes how federal credit unions can be legally chartered and organized. It discusses what actions a federal credit union has the legal authority to perform; these are called the federal credit unions powers. Title I specifies information about credit union governance including requirements for the board, annual meetings, supervisory committees, and information about the rights of credit union members.

MORE INFORMATION: For more information on credit union powers, see Section 6 of this chapter.

Under Title I of the FCU Act, field of membership is also delineated. Federal credit unions must be chartered with distinct fields of membership that share a common bond. The most updated version of NCUA's Chartering and Field of Membership manual can be found in Appendix B to 12 CFR Part 701. This aspect of federal credit union organization has undergone significant change in the past twenty years. Most notably in 1998, as the result of a Supreme Court decision in *NCUA v. First National Bank & Trust*, Congress passed the Credit Union Membership Access Act (CUMAA). The CUMAA reversed the ruling from the court case, authorizing a credit union to have multiple common bonds among its membership.

Title II - Share Insurance

The National Credit Union Share Insurance Fund (NCUSIF) is the federal fund created by Congress in 1970 to insure member's shares in federally insured credit unions. NCUA was created in part to advance the creation of such a fund. The insurance limit was permanently increased from $100,000 to $250,000 by passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) on July 21, 2010, and NCUA amended its rules on September 17, 2010, to reflect the change.

By law, federally insured credit unions maintain one percent of the credit union's shares in the NCUSIF. The NCUA Board is permitted by the FCU Act to administer the NCUSIF and set the normal operating level between 1.20 percent and 1.50 percent. Currently, the NCUSIF normal operating level is set to be maintained at or near 1.33 percent of federally insured credit union deposits. The NCUA Board can levy a premium or assessment if necessary and must report to Congress if the equity ratio of the fund falls below 1.20 percent.

Title III - Central Liquidity Facility

The Central Liquidity Facility (CLF) is a mixed ownership government corporation created to help improve the financial stability of credit unions and serve as a liquidity lender to credit unions experiencing unusual or unexpected liquidity shortfalls. The CLF was added to the FCU Act in 1978. Member credit unions own the CLF that exists within NCUA. The president of the CLF manages the facility under the oversight of the NCUA Board.

Membership is voluntary and open to all credit unions that purchase a prescribed amount of CLF stock. There are two types of membership, regular (natural person credit unions) and agent (corporate credit unions). Natural person credit unions may borrow from the CLF either directly as a regular member or indirectly through an agent member.

Credit unions are not required to maintain access to the CLF; however, NCUA issued a liquidity final rule that became effective March 31, 2014. The rule requires federally insured credit unions with less than $50 million in assets to maintain a basic written policy that provides a credit union board-approved framework for managing liquidity and a list of contingent liquidity sources that can be employed under adverse circumstances. The rule requires federally insured credit unions with assets of $50 million or more to have a contingency funding plan that clearly sets out strategies for addressing liquidity shortfalls in emergency situations. Finally, section 741.12 requires federally insured credit unions with assets of $250 million or more to have access to a backup federal liquidity source for emergency situations.

OVERVIEW OF THE NCUA

NCUA is the regulatory agency housed in the Executive Branch of government that oversees the activities of federally chartered, and to some extent, federally insured credit unions. NCUA is an independent agency, and is controlled by a three member board. The agency charters, supervises and insures federal credit unions and insures most state chartered credit unions.

MORE INFORMATION: NCUA's Historical Timeline **also provides a brief history of NCUA, its leadership and major changes to its organizational structure.**

ADMINISTRATIVE BODIES

All agencies of the federal government are governmental units that exhibit some characteristics of the legislative, executive and judicial branches. NCUA is an administrative body that was specifically created by Congress when it passed the FCU Act. Unlike some government agencies, NCUA receives its authority directly from Congress; its authority is not delegated from a presidential action or order. NCUA is also fully funded by the credit unions it insures and does not rely on the government for funding. As an independent agency, NCUA does, however, often follow the spirit of executive orders or other presidential decrees.

All administrative bodies follow the rules set out in the Administrative Procedure Act (APA) in the proposal and establishment of regulations. The APA, codified at 5 USC § 551, sets out rules regarding how agencies can create regulations, including notice and comment to the public. It also sets out the rules regarding adjudicatory actions and discusses judicial review of agency action.

NCUA BOARD

The NCUA Board is a three member board. The board members are appointed by the president, and confirmed by the Senate. The president designates one of the members to be chairman and no more than two members may be of the same political party. Also, by statute, only one of the three board members may at the time of the appointment, be currently involved or recently involved with any insured credit union as a committee member, director, officer, employee or other institution-affiliated party.

NCUA board members serve staggered six-year terms, and may only serve multiple terms if their original term was to fill out an unexpired term of another individual. Board members whose terms expired may continue to serve until a successor has been confirmed and seated.

MORE INFORMATION: NCUA's website includes biographical information on the agency's senior leadership and current board members.

The chairman is the liaison between the NCUA Board and other government agencies and directs the activities of the agency. For example, NCUA is a member of the Federal Financial Institutions Examination Council (FFIEC), an interagency body empowered to prescribe uniform principles, standards and forms to ensure consistency among federal regulators.

NCUA Board Authorities

The NCUA Board has different types of authorities based on the type of activity being overseen and carried out. In general, NCUA has significant authority to approve rules and regulations governing federal credit unions. NCUA also has significant authority relative to keeping credit unions safe and sound, so some regulations apply to all federally insured credit unions. The NCUA Board may delegate some of its authority to agency staff, including the directors of the regional offices. The board's authority includes administering NCUA's prompt corrective action regime to ensure capital soundness. NCUA may also conserve or liquidate a credit union to protect the share insurance fund. The agency approves federal credit union charters, reviews field of membership changes for federal credit unions and evaluates merger applications from all federally insured credit unions. As an adjudicator, the agency hears administrative actions such as when a credit union appeals the denial of a charter application or an examination finding.

MORE INFORMATION: Attending or viewing an NCUA board meeting is a great way to get an introduction to the rulemaking process.

The NCUA Board typically has monthly board meetings, except during the month of August. It approves rulemakings during its meetings and may approve charter applications. NCUA records board meetings and provides an archived video of the meetings on its website.

NCUA ORGANIZATION

NCUA is divided into offices, both in the central headquarters and in regions. Under the direction of the chairman, NCUA has the Office of Minority & Women Inclusion and the Office of External Affairs & Communications. The Office of the Executive Director, Office of General Counsel, Office of Inspector General and the Office of Ethics Counsel report to the NCUA Board.

RESEARCH TIP: The NCUA website is a great resource as it provides the organizational structure of the agency and very basic information on how the agency operates.

In addition, other central offices and regional offices report to the Executive Director: Office of Examination and Insurance, Office of National Examinations and Supervision, Office of Chief Financial Officer, Office of Chief Information Officer, Office of Credit Union Resources and Expansion, Office of Human Resources, Office of Public and Congressional Affairs, Office of Consumer Protection & Access, Eastern Regional Office, Southern Regional Office, and the Western Regional Office. The contact information for each of the offices can be found on the NCUA contact page.

Regional Offices

NCUA maintains three regional offices throughout the country. Each regional office is responsible for oversight, examination and supervision of the federally insured credit unions in its geographical region.

The Eastern Region is located in Alexandria, Virginia, and consists of credit unions from Connecticut, Delaware, the District of Columbia, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia, and West Virginia.

The Southern Region is located in Austin, Texas, and consists of credit unions from Alabama, Arkansas, Florida, Georgia, Indiana, Kentucky, Louisiana, Mississippi, North Carolina, Oklahoma, Puerto Rico, South Carolina, Tennessee, Texas and the U.S. Virgin Islands.

MORE INFORMATION: Prior to January 7, 2019, the agency maintained five regional offices that were consolidated as part of a lengthy reorganization process that began in 2017.

The Western Region is located in Tempe, Arizona, and consists of credit unions from Alaska, Arizona, California, Colorado, Guam, Hawaii, Idaho, Illinois, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, Wisconsin, and Wyoming.

Additionally, the Asset Management and Assistance Center (AMAC), located in Austin, Texas, performs management and recovery of assets and is responsible for conducting credit union liquidations. AMAC also assists NCUA regional offices with the review of large complex loan portfolios and actual or potential bond claims.

Office of the General Counsel

The Office of General Counsel has responsibility for all legal matters affecting NCUA, including: representing the agency in litigation; bringing enforcement actions against directors, managers and other parties affiliated with credit unions; providing interpretations of the FCU Act and NCUA rules and regulations to the agency and to outside parties; processing Freedom of Information Act requests and appeals; advising the NCUA Board and the agency on general legal matters; and drafting regulations designed to implement statutes or ensure the safety and soundness of credit unions.

Office of Consumer Financial Protection

Established in 2010, the Office of Consumer Financial Protection reflects NCUA's heightened focus on consumer protection. Within the office, the Division of Consumer Affairs is responsible for the agency's consumer financial literacy efforts and manages the consumer websites, MyCreditUnion.gov and Consumer Assistance Center, which handle consumer inquiries, education and complaints. The Division of Consumer Compliance Policy and Outreach is responsible for consumer protection compliance and rulemaking, fair lending examinations and interagency coordination and outreach. Finally, the Division of Consumer Access is responsible for chartering and field-of-membership matters, low-income designations, charter conversions and bylaw amendments.

Office of Credit Union Resources and Expansion

The Office of Credit Union Resources and Expansion, or CURE, began operations on January 7, 2018, as part of NCUA's strategic realignment and modernization of its offices. CURE's mission is to support credit union growth and development, offering assistance to any credit union in the following areas: chartering; charter conversions; bylaw amendments; field of membership expansion requests; and low-income designations. CURE also provides online training, grants and loans through the Community Development Revolving Loan Fund and a program for minority institutions.

RESEARCH TIP: NCUA's Support Services page provides resources and frequently asked questions on a variety of topics related to CURE.

Office of Examination and Insurance

The Office of Examination and Insurance provides national guidance for NCUA's efforts to assure the safety and soundness of federally insured credit unions. The Division of Supervision oversees NCUA's examination and supervision program. The Division of Risk Management oversees and directs NCUA's credit union problem resolution program. The Division of Analytics and Surveillance manages data-gathering, surveillance and national risk assessment programs and supports NCUA's supervision of technology risk in credit unions. The Division of Capital and Credit Markets evaluates and develops policies and procedures related to credit union loans and investments and asset liability management. The division also oversees the Central Liquidity Facility. Finally, the Division of NGN Support monitors the NCUA Guaranteed Notes (NGN) program.

Office of Inspector General

The Office of Inspector General (OIG) promotes the economy, efficiency and effectiveness of NCUA programs and operations, and detects and deters fraud, waste and abuse, thereby supporting the agency's mission of monitoring and promoting safe and sound federally insured credit unions. The OIG conducts independent audits, investigations and other activities, and keeps the NCUA Board and Congress fully and currently informed of its work. The reports from the OIG include Audit Reports, Material Loss Reviews, Performance and Strategic Plans, Semiannual Reports to Congress and Other Investigative Reports.

CHAPTER 1 — FUNDAMENTALS

SECTION 3 — THE CONSUMER FINANCIAL PROTECTION BUREAU

OVERVIEW

The Consumer Financial Protection Bureau (CFPB or bureau) was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The CFPB was granted authority to enforce the consumer laws referenced in the Act as well as additional powers to protect consumers in financial markets. The bureau's powers extend beyond traditional depository institutions. For example, the CFPB has the authority to regulate and supervise payday lenders, credit reporting agencies and debt collectors that were previously regulated by the Federal Trade Commission.

For credit unions, the CFPB has the authority to examine and supervise institutions with more than $10 billion in assets. Credit unions with $10 billion or less in assets are examined and supervised by NCUA and, for state-chartered credit unions, their state regulator. Importantly, the CFPB's examination and supervision powers are generally limited to the consumer laws and regulations under its authority. NCUA will continue to examine *all credit unions* for safety and soundness.

CFPB's Authority over Nonbanks

Dodd-Frank granted the CFPB the authority to supervise nonbank entities in three markets:

1. Mortgage origination and servicing;
2. Payday lending; and
3. Private education lending.

The CFPB has the ability to supervise entities operating in these markets regardless of their size. It examines these entities under its Nonbank Supervision Program.

Dodd-Frank also gave the CFPB the ability to regulate and supervise "larger participants" in other markets for financial products and services. The bureau needs to issue regulations to define "larger participants" as well as determine which markets it will regulate. For example, in 2012, the bureau issued a final rule defining "larger participants" in the consumer reporting market.

In addition to credit reporting, the CFPB has also looked at "larger participants" in these markets:

- Debt collection;
- Consumer credit and related activities;
- Money transmitting, check cashing and related activities;
- Student loan servicing;

- Auto lending;
- Prepaid cards; and
- Debt relief services.

The CFPB's authority is not limited to these markets. It could determine to regulate other markets in the future. Unlike the CFPB's regulation of mortgage originators, payday lenders and private education lenders, the bureau's authority in these other consumer markets is limited to "larger participants." It is required to define "larger participants" for each nonbank market it regulates.

BASICS OF THE CFPB

The CFPB is an independent agency that derives its powers from Dodd-Frank. The bureau is technically housed within the Federal Reserve but its powers are completely separate. In practice, the CFPB's budget is drawn from the Federal Reserve, but the bureau has autonomy in its actions.

The CFPB is led by a single director appointed by the president and confirmed by the Senate. The director's term is five years.

Importantly, the CFPB's mission is focused solely on protecting consumers. Unlike NCUA, the bureau does not have a requirement to consider the impact of its actions on the safety and soundness of the entities it is regulating. The CFPB's mission is as follows:

> *"The [CFPB] is a 21st century agency that implements and enforces Federal consumer financial law and ensures that markets for consumer financial products are fair, transparent, and competitive."*

Like other federal regulators, the CFPB must follow the Administrative Procedure Act (APA) notice and comment rulemaking process. The APA, codified at 5 USC § 551 et seq., sets out rules regarding how agencies can create regulations, including notice and comment to the public, adjudicatory actions and discusses judicial review of agency action.

Dodd-Frank requires the CFPB to analyze the impact of its regulations on smaller institutions. Specifically, section 1022(b)(2) of Dodd-Frank requires the bureau to determine the impact of its regulations on banks and credit unions with $10 billion or less in assets.

NAFCU NOTE

For a detailed discussion of section 1022(b)(2), see this NAFCU *Compliance Blog* post.

STRUCTURE OF THE CFPB

Under section 5491(b), the CFPB has a single director responsible for running the CFPB. This contrasts with other federal regulators, including NCUA, which are run by boards. This is an important distinction as the bureau does not hold regularly scheduled board meetings to announce its newly proposed or finalized regulations. Instead, the CFPB – due to its structure with a single director – can issue new regulatory proposals at any time and without advanced notice to the entities being regulated. In practice, the bureau will often make major announcements in connection with field hearings located throughout the country.

In addition to the director, the CFPB has five divisions responsible for different aspects of the bureau's duties. Below are additional details on each of these divisions.

NAFCU NOTE

In June 2020, the Supreme Court found the CFPB's single-director structure violated the separation of powers of the U.S. Constitution because the director could only be removed for cause. The Supreme Court effectively removed this provision from Dodd-Frank, and the director may now be removed by the President at will. Check out this NAFCU *Compliance Blog* post for more.

RESEARCH TIP: The CFPB's organization chart is a useful tool to understand the structure of the bureau. Many of the CFPB's divisions and offices have dedicated webpages with additional resources and tools for credit unions and members.

Consumer Education & External Affairs

The Consumer Education & External Affairs division consists of four offices. Each office has a unique focus and works to highlight consumer financial protection issues under its authority.

Historically, financial regulation has been product-based. For example, there are specific requirements if an institution wants to offer credit card accounts. The following offices at the CFPB will be looking not only at the products but also how the financial products impact specific consumers – such as older Americans, servicemembers and other vulnerable consumers. The offices include:

- Consumer Education;
- Stakeholder Management
- Public Affairs; and
- Consumer Response.

These offices provide consumers with information, tools and materials to help them make informed decisions through the CFPB's website, social media, outreach and education. Beyond providing financial literacy to members, this division also handles consumer complaints, as well as communications with multiple groups that are impacted by the bureau's actions.

Research, Markets & Regulations

This division is responsible for implementing the CFPB's regulatory rulemaking authority. The division consists of six main offices: research; consumer credit, payments, & deposit markets; regulations; mortgage markets, small business lending markets; and competition & innovation.

These offices investigate, analyze, and monitor market data to provide reports for other departments of the CFPB, and to implement and ensure the regulations are issued and interpreted in an informed, fair and efficient manner.

MORE INFORMATION: For certain rulemakings, the CFPB must establish Small Business Review Panels to review the potential rulemaking and examine the economic impact on small entities.

Supervision, Enforcement & Fair Lending

This division is responsible for supervision and enforcement of the consumer financial protection laws under the CFPB's authority. This supervision includes examination of depository institutions with more than $10 billion in assets as well as nonbanks that provide consumer financial products and services in certain financial markets. The offices include:

- Supervision Policy;
- Supervision Examinations; and
- Enforcement.

These offices train examiners, execute examinations, set the CFPB's supervisory policy through the Supervision and Examination Manual, investigate potential violations and pursue enforcement actions.

RESEARCH TIP: **The Supervision and Examination Manual may be useful to all credit unions as it explains current regulatory requirements. Additionally, NCUA could follow the CFPB's lead and adopt similar procedures in the future to ensure examination consistency.**

Operations

This division of the CFPB handles primarily internal issues regarding the bureau's operations. For example, this division handles the bureau's budget and manages the CFPB's responses to Freedom of Information Act (FOIA) requests, and includes the offices of administrative operations, human capital, office of the chief data officer, finance and procurement, and technology and innovation.

Legal

The CFPB has a Legal Division which is responsible for the bureau's interpretation of consumer laws and regulations as well as laws impacting the CFPB's operations. This division advises the director and the CFPB's other divisions on their actions and potential actions. The division also defends the bureau if a lawsuit is brought against it by a third party. This division also has a role in drafting guidance documents for the industry. Offices in this division include general law & ethics, law & policy and litigation & oversight.

Advisory Committees

The CFPB created a Consumer Advisory Board consisting of various stakeholders and providing the bureau with input on its operations and future actions. The CFPB also created a Credit Union Advisory Council to better inform the bureau's policy development, rulemaking and engagement functions.

THE CFPB'S REGULATORY AUTHORITY

Dodd-Frank transferred authority from existing regulators to the CFPB for enforcing the "enumerated consumer laws" and their implementing regulations. The CFPB has authority for interpreting and enforcing (NCUA and state regulators retain primary enforcement authority for credit unions with $10 billion or less in assets) the "enumerated consumer laws." There are eighteen enumerated consumer laws currently. Congress could create a new "consumer law" and give the bureau the authority to enforce that new law as well.

RESEARCH TIP: The CFPB's Compliance Webpage contains links to supervision and examination resources, guidance and the periodically release Supervisory Highlights which shares recent examination finds and trends.

Enumerated Consumer Laws

- Below is a listing of the eighteen enumerated consumer laws, which can be found *at* 12 USC § 5481(12). Keep in mind that each law has a different scope and not every law below applies to credit unions.
- Alternative Mortgage Transaction Parity Act of 1982 – 12 USC § 3801 et seq.;
- Consumer Leasing Act of 1976 – 15 USC § 1667 et seq.;
- Electronic Funds Transfer Act – 15 USC § 1693 et seq.;

MORE INFORMATION: The authority over the Electronic Fund Transfer Act does not include section 920 on interchange. The Federal Reserve has authority over the interchange rules.

- Equal Credit Opportunity Act – 15 USC § 1691 et seq.;
- Fair Credit Billing Act – 15 USC § 1666 et seq.;

- Fair Credit Reporting Act – 15 USC § 1681 et seq.;

MORE INFORMATION: The authority over the Fair Credit Reporting Act does not include section 1681m(e) on identity theft red flags and section 1681w on records disposal. NCUA has authority over these provisions.

- Homeowners Protection Act of 1998 – 12 USC § 4901 et seq.;
- Fair Debt Collection Practices Act – 15 USC § 1692 et seq.;
- Federal Deposit Insurance Act (Subsections (b) - (f) of Section 43) – 12 USC § 1831t(c)-(f);
- Gramm-Leach-Bliley Act (Sections 502 through 509) – 15 USC §§ 6802 - 6809;

MORE INFORMATION: The authority over the Gramm-Leach-Bliley Act does not include section 6801(b), commonly known as the Safeguards Rule. NCUA has authority over this rule.

- Home Mortgage Disclosure Act of 1975 – 12 USC § 2801 et seq.;
- Home Ownership and Equity Protection Act of 1994 – 15 U.C § 1601;
- Real Estate Settlement Procedures Act of 1974 – 12 USC § 2601 et seq.;
- S.A.F.E. Mortgage Licensing Act of 2008 – 12 USC § 5101 et seq.;
- Truth in Lending Act – 15 USC § 1601 et seq.;
- Truth in Savings Act – 12 USC § 4301 et seq.;
- Omnibus Appropriations Act of 2009 (Section 626) – Public Law 111-8; and
- Interstate Land Sales Full Disclosure Act – 15 USC § 1701.

The CFPB gained authority for these enumerated consumer laws on July 21, 2011.

Inherited Regulations

In addition to authority over the enumerated consumer laws, Dodd-Frank also transferred authority over the implementing regulations. Thus, the CFPB inherited numerous existing regulations that were previously written and interpreted by other federal regulators. The bureau obtained authority over these regulations on July 21, 2011. In late 2011, the CFPB republished these regulations in the Electronic Code of Federal Regulations to move the regulations under Title 12, Chapter X (Sections 1000 - 1099).

Below is a listing of most of the regulations that were transferred to the CFPB. These regulations implement the enumerated consumer laws.

- Regulation B – Equal Credit Opportunity Act – 12 CFR Part 1002;
- Regulation C – Home Mortgage Disclosure Act – 12 CFR Part 1003;
- Regulation D – Alternative Mortgage Transaction Parity – 12 CFR Part 1004;
- Regulation E – Electronic Funds Transfers – 12 CFR Part 1005;
- Regulation F – Fair Debt Collection Practices Act – 12 CFR Part 1006;
- Regulation G – SAFE Mortgage Licensing Act (federal) – 12 CFR Part 1007;

MORE INFORMATION: Regulation G applies to both state-chartered and federally-chartered credit unions. In short, depository institutions fall under Regulation G (federal) and non-depository institutions fall under Regulation H (state).

- Regulation M – Consumer Leasing – 12 CFR Part 1013;
- Regulation N – Mortgage Acts and Practices Advertising – 12 CFR Part 1014;
- Regulation P – Privacy of Consumer Financial Information – 12 CFR Part 1016;
- Regulation V – Fair Credit Reporting – 12 CFR Part 1022;
- Regulation X – Real Estate Settlement Procedures Act – 12 CFR Part 1024;
- Regulation Z – Truth in Lending – 12 CFR Part 1026; and
- Regulation DD – Truth in Savings – 12 CFR Part 1030.

It is important to remember that some regulations that impact consumers *were not* transferred to the CFPB. Examples of these regulations would be: Regulation D (reserve requirements); Regulation CC (funds availability and collection of checks); and Regulation GG (Unlawful Internet Gambling Enforcement Act).

RESEARCH TIP: After Dodd-Frank, jurisdiction over Regulation CC was split down the middle. The CFPB gained authority over Subpart A (general requirements) and Subpart B (funds availability); while the Federal Reserve retained authority over Subpart C (collection of checks) and Subpart D (Check 21).

Truth in Savings

The Truth in Savings Act has a special requirement that NCUA implement the regulations for credit unions. Prior to Dodd-Frank, the Federal Reserve was tasked with implementing Truth in Savings for banks (Regulation DD) and NCUA was under a requirement to have a "substantially similar" regulation for credit unions (12 CFR Part 707). Dodd-Frank transferred authority for Regulation DD to the CFPB; however, this did not impact credit unions' requirements under Truth in Savings.

The language of the CFPB's Regulation DD is clear that it does not cover credit unions, stating it "applies to depository institutions except for credit unions." NCUA's regulation is located in Part 707 and all credit unions need to comply with the agency's version of Truth in Savings rather than CFPB's Regulation DD.

MORE INFORMATION: Footnote 2 of the CFPB's republishing of Regulation DD contains an explanation of NCUA's TISA rulemaking authority.

The U.S. Code still requires NCUA to adopt a "substantially similar" regulation within 90 days. This means NCUA will need to follow the CFPB's lead on Truth in Savings issues just as they did in the past following the Federal Reserve.

MORE INFORMATION: For details on NCUA's TISA regulations, see Chapter 2, Section 4.

Unfair, Deceptive or Abusive Acts or Practices (UDAAP)

Dodd-Frank granted the CFPB the ability to define "unfair, deceptive or abusive acts or practices" (UDAAPs) in any transaction with a consumer for a consumer financial product or service. The CFPB has rulemaking authority to indicate a certain act or practice is "unfair, deceptive or abusive" and prohibit depository institutions and nonbanks from engaging in those acts or practices.
Prior to Dodd-Frank, the Federal Trade Commission had authority to deem acts or practices as "unfair or deceptive." Additionally, NCUA and the federal banking authorities had the ability to deem certain acts or practices as "unfair or deceptive" – commonly referred to as UDAP.

The CFPB's authority, from Dodd-Frank, expands the threshold from "unfair or deceptive" to "unfair, deceptive or abusive." This expanded authority means the bureau has the ability to identify acts or practices as "abusive" to consumers even though those acts or practices may not have met the test of being "unfair or deceptive" in the past.

All entities that fall under the CFPB's authority, including credit unions, need to closely monitor the bureau's use of its UDAAP authority. A credit union with $10 billion or less in assets will be examined for UDAAP issues by NCUA or its state regulator.

Unfair Acts or Practices

The standard for unfairness under Dodd-Frank is that an act or practice is unfair when:

- It causes or is likely to cause substantial injury to consumers;
- The injury is not reasonably avoidable by consumers; and
- The injury is not outweighed by countervailing benefits to consumers or to competition.

This standard is the same three-part test for unfairness in the Federal Trade Commission Act.

Deceptive Acts or Practices

A representation, omission, act or practice is deceptive when:

- The representation, omission, act or practice misleads or is likely to mislead the consumer;
- The consumer's interpretation of the representation, omission, act or practice is reasonable under the circumstances; and
- The misleading representation, omission, act or practice is material.

A 1983 FTC Policy Statement contains a thorough discussion of the deceptive test.

Abusive Acts or Practices

Dodd-Frank granted the CFPB the ability to also identify "abusive" acts or practices. According to Dodd-Frank, an act or practice is abusive if it:

- Materially interferes with the ability of a consumer to understand a term or condition of a financial product or service; or
- Takes unreasonable advantage of –
    - A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
    - The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or
    - The reasonable reliance by the consumer on a covered person to act in the interest of the consumer.

RESEARCH TIP: The CFPB lists recent enforcement actions on its website which can be filtered by keywords which can aid in tracking. The CFPB's Supervision and Examination Manual also has a section on UDAAP that is helpful for researching the standards and tests used for determining if something is unfair, deceptive or abusive.

CREDIT UNIONS AND THE CFPB'S REGULATIONS

The transfer of authority to the CFPB means that all credit unions need to comply with the bureau's regulations. This requirement applies regardless of the size of the credit union. A credit union with $15 million in assets is required to follow Regulation Z as well as a credit union with $250 million in assets.

Not every CFPB regulation will apply to credit unions. Additionally, not every CFPB regulation will apply to all credit unions. In terms of enforcement, remember that for credit unions with $10 billion or less in assets, NCUA (or the credit union's state regulator) will examine for compliance with the CFPB's regulations. Credit unions with more than $10 billion in assets will be examined for compliance by the CFPB directly.

NAFCU NOTE

For more information on the CFPB's latest action, have a look at NAFCU *Compliance Blog* post entries on the CFPB.

RESEARCH TIP: The CFPB's Rules & Policy webpage contains links to its Regulatory Agenda, Rules Under Development and Final Rules. At the Notice and Comment webpage, credit unions can review and provide feedback on the bureau's proposed rules.

CONSUMER COMPLAINTS

The CFPB actively encourages consumers (including credit union members) to file complaints against the entity providing their financial product or service. The bureau collects complaints on its website as well as by telephone, mail, email and fax. The CFPB website has places where consumers can "Tell Your Story" and "Submit a Complaint."

NAFCU NOTE

The bureau does not verify the accuracy of member complaints – an issue that NAFCU has raised with the bureau and could lead to reputation risk for credit unions since they are publicly available. For information on the current complaint process, check out past NAFCU *Compliance Blog* posts on the issue.

The CFPB's Consumer Response team screens all complaints submitted by consumers. They determine if the complaints are original and complete as well as if the complaints involve issues under the bureau's authority. The complaints are then sent to the appropriate entity – such as a bank or credit union. The entity reports back to the consumer and the CFPB with its response. The bureau can follow-up if the entity fails to provide a timely response or the consumer disputes the response.

The CFPB collects its complaints in a centralized database that is publicly accessible. Importantly, the CFPB refers all complaints for credit unions with $10 billion or less in assets to NCUA or the credit union's state regulator. For federal credit unions, complaints are handled by NCUA's Office of Consumer Protection. For additional information on the agency's complaint process, see Letter to Credit Unions 15-CU-04 which updates the process set forth in Letter to Credit Unions 11-CU-17.

CHAPTER 1 — FUNDAMENTALS

SECTION 4 — NCUA SUPERVISION AND EXAMINATION

OVERVIEW

NCUA derives its supervisory authority from the Federal Credit Union Act. Its main supervisory purpose is to monitor credit unions' overall financial and operational health, to ensure safety and soundness of the credit union system and the NCUA Credit Union Share Insurance Fund (NCUSIF) and to determine their compliance with applicable laws and regulations. The line between supervision and examination is often blurred, as the on-site (or virtual) examination is the primary tool an examiner may use to supervise credit unions. However, the on-site examination is just one method, albeit the main method, of the overall supervision of credit unions. An examiner and the regional office may have continuing contact and oversight of a credit union outside the regularly scheduled examination.

NCUA's examination process is a risk-focused program designed to focus examiner attention and resources on areas showing weaknesses and adverse trends. It is a forward-looking approach rather than a comparison of performance against predetermined benchmarks. The examiner generally will derive these high-risk areas from previous examinations, his or her review of the credit union's call report, and general downward trends in the industry. New products and services will likely be considered a higher risk to the credit union than those with which the credit union has vast experience.

MORE INFORMATION: When NCUA issues a Letter to Credit Unions containing a Supervisory Letter, NCUA has also distributed this to your examiner. These Supervisory Letters usually outline recent areas of concern.

The risk-focused examination is different from an audit and serves a different role. Generally, an audit will assess how a credit union is operating to date; a financial audit verifies the credit union's financial statements. The purpose of the examination is to determine areas of risk to the credit union's operational and financial health. Audits are generally assessments of the credit union that look to the past, whereas examinations have an eye on the credit union's future.

This risk-focused process provides examiners with flexibility to focus on areas they see as exhibiting current, or potential risk to the credit union and the overall system. However, there are three requirements each examination must include:

- Reviewing the accuracy of the 5300 Call Report data;
- Reviewing the supervisory committee audit; and
- Reviewing the credit union's compliance with the Bank Secrecy Act.

Once the minimum requirements have been met, examiners may turn towards areas that reveal pertinent risk characteristics.

Since 2014, NCUA has required all federally insured credit unions to file quarterly call reports and profile data electronically using NCUA's information management system or other electronic means specified by the agency. Manual filing of this information is no longer an option for federally insured credit unions.

RESEARCH TIP: Credit unions looking for more information about what examiner expectations are on a specific issue can review the Examiner's Guide and the Modern Examination & Risk Identification Tool (MERIT) which examiners use to review a specific substantive area. In October 2016, NCUA launched an interactive, online version of the Examiner's Guide, which it is updating in sections on a rolling basis.

EXAMINATION AUTHORITY

Dodd-Frank amended the long-standing examination authorities. NCUA maintains examination authority over all credit unions for safety and soundness purposes. This includes credit unions over $10 billion in assets. This is due to NCUA's role as protector of the NCUSIF.

For compliance with consumer regulations, Dodd-Frank gave the CFPB direct examination authority for credit unions with more than $10 billion in assets. Thus, for these large credit unions the CFPB will examine for compliance with the consumer regulations, but NCUA will examine for safety and soundness.

For federal credit unions with $10 billion or less in assets, NCUA will examine for both compliance with consumer regulations and overall safety and soundness.

For state-chartered credit unions that are federally-insured and have $10 billion or less in assets, NCUA will examine for safety and soundness and the state regulator will examine for compliance with consumer regulations.

Importantly, absent an applicable exception, *all credit unions* are subject to the CFPB's regulations – even if they are examined by a different regulator.

SPECIAL NCUA EXAMINATION PROGRAMS

NCUA has developed special examinations for very large credit unions as well as very small, well-managed federal credit unions.

Credit Unions Above $15 Billion

The examination of natural person credit unions above $15 billion in assets as well as all corporate credit unions will be performed by NCUA's Office of National Examinations and Supervision. This office began examining large credit unions in 2014.

MORE INFORMATION: NCUA amended its regulations to revise the $10 billion asset threshold used for assigning supervision of consumer federally insured credit unions (FICUs) to the Office of National Examinations and Supervision (ONES). This final rule from NCUA states that "covered credit unions with less than $15 billion in total assets (tier I credit unions) will be supervised by the appropriate NCUA Regional Office. Covered credit unions with $15 billion or more in total assets (tier II and tier III credit unions) continue to be supervised by ONES." The final rule is effective January 1, 2023.

Federal Credit Unions Below $10 Million

NCUA has a Small Credit Union Examination Program that is used for certain *federal credit unions* below $10 million in assets. Federal credit unions with total assets of less than $10 million and a CAMELS rating of 1, 2 or 3 will be eligible for the program. Under the program, NCUA indicates examinations should be limited to approximately 40 hours for well-managed credit unions. Examinations for these small credit unions will focus on specific areas of risk—including lending, recordkeeping and internal controls. For additional information, see NCUA's Letter to Federal Credit Unions No. 12-FCU-03.

AREAS OF RISK EVALUATION

For an examiner, risk is the potential that future events may have an adverse effect on the credit union's net worth and earnings. There are seven areas of risk evaluation that drive the examination process: credit risk, liquidity risk, interest rate risk, transaction risk, compliance risk, strategic risk and reputation risk.

How an examiner judges the credit union's management of these risks will factor into the overall examination result, as well as the credit union's CAMELS Rating. The seven areas of risks are discussed briefly below.

Credit Risk

Credit risk is the current and prospective risk to earnings or capital arising from a person's failure to meet the terms of a contract with the credit union or otherwise fail to perform as agreed. It exists in activities where the credit union invests or loans funds and expects repayment. For example, the credit union loans funds to a member to buy a house. The risk that *the member* will default and not repay the loan is credit risk.

Liquidity Risk

Liquidity risk is the risk that the credit union cannot meet its obligations when they come due without incurring significant costs and/or unacceptable losses. Liquidity risk includes the inability to manage funding sources and can arise from the credit union's failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.

Interest Rate Risk

Interest rate risk is the risk that changes in market rates will adversely affect a credit union's capital and earnings. Interest rate risk can affect the price of investments as well as the value of a credit union's loan portfolio and fee income.

Transaction Risk

Transaction risk is also referred to as fraud risk or operating risk and is the risk to capital and earnings arising from fraud or error that results in an inability to deliver products or services, maintain a competitive position and manage information. It is a function of internal controls, employee integrity and operational systems.

Compliance Risk

Compliance risk exposes the credit union to fines, civil money penalties, damage awards and termination of contracts. It is the risk borne from violations of laws, rules, regulations, internal policies and procedure, and ethical standards. It may also arise from ambiguous and untested laws affecting credit union operations.

Strategic Risk

Strategic risk stems from adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes. Credit unions face increased strategic risk when expanding into new markets or developing new products. To help mitigate these risks, credit unions perform due diligence to inform their business decisions.

Reputation Risk

Reputation risk can affect the credit union's ability to maintain current relationships and services, as well as attract new members. It can also expose the credit union to litigation and financial loss. It is the risk to the credit union's capital and earnings arising from negative public opinion or perception. In other words, when looking into whether or not it can do something, the credit union needs to also consider whether it "should" do something. Always consider how your members (current and prospective) will perceive a certain action.

CAMELS RATING SYSTEM

The seven risk categories mentioned above are assigned a risk level, which will be reflected in the appropriate CAMELS codes. The CAMELS system is designed to evaluate the soundness of a credit union and identify those credit unions that need additional supervisory attention. The CAMELS system is made up of five components: Capital Adequacy, Asset Quality, Management, Earnings, Liquidity & Asset-Liability Management and Sensitivity to Market Risk. Examiners rate each component on a scale from 1 to 5 (1 being the best). The credit union also receives an overall composite rating from 1 to 5. Below is a brief discussion of each of the components.

Capital Adequacy

The key capital ratio is net worth/total assets. Regulatory capital requirements contain minimum required capital levels. A well-capitalized credit union is one with a 7 percent ratio or higher; any credit union with a ratio under 6 percent is less than adequately capitalized and must implement a net-worth restoration plan. But for the examination, the net worth/total assets ratio is only part of the equation. An examiner will also look to whether the credit union's capital is sufficient to withstand the risk inherent in the credit union's operations. The regulatory requirements are a minimum – the examiner may feel that the risk the credit union is exposed to requires a higher level of capital. The rating the credit union receives will correspond to the amount and quality of its capital relative to its current and prospective risk profile (i.e., a rating of 1 indicates sound capital relative to the credit union's risk profile).

MORE INFORMATION: NCUA issued a risk-based capital rule that will require federally-insured natural person credit unions with assets over $500 million to hold additional capital commensurate with the risk profile of the credit union in order to be considered "well capitalized." The stated purpose of this risk-based capital rule is to bring NCUA's capital requirements for federally-insured credit unions in line with the requirements for similar institutions insured by the FDIC. The effective date has been delayed until January 1, 2022. For more information, review NAFCU's Capital Reform page.

Asset Quality

Assets are the property the credit union owns and include fixed assets, loans and investments. The evaluation of asset quality will include a review of various factors including the following: management's control of credit risk; the credit union's allowance for loan and lease losses policy; the quality of loan underwriting policies and procedures; internal controls in place to review new and existing loan programs; existence of significant loan concentrations; and the appropriateness of investment policies and practices.

Management

There are no specific ratios to evaluate management. Examiners evaluate whether management is operating under sound business practices. Management's ability to respond to changing business environments and to skillfully implement new products and services is significant in evaluating the credit union's risk profile and thus the management rating is important to the credit union's overall composite rating. The performance of management is evaluated based upon factors such as: corporate governance; strategic planning; and internal controls. NCUA points to seven aspects of internal controls that deserve special attention: information systems; segregation of duties; audit program; recordkeeping; protection of physical assets; education of staff; and succession planning.

Earnings

Examiners will look at past and current earnings, but will also evaluate possible future earnings. The credit union must earn an adequate return on assets to fund its expenses and dividends, as well as to spark capital growth and fund the allowance for loan and lease losses. Earnings can be affected by factors such as credit risk management, market risk, unforeseen operating expenses and economic climate.

Liquidity and Asset-Liability Management

On a basic level, asset-liability management (ALM) is the practice of maintaining sufficient liquidity to meet the credit union's financial obligations, without going overboard. If the credit union has too many liquid assets it is probably not maximizing its earnings. Thus, ALM practices are a careful balance between maintaining adequate net income and liquidity at the same time. Liquidity risk and interest rate risk are two risk areas that will factor heavily in the ALM rating.

Sensitivity to Market Risk

Sensitivity to Market Risk considers the exposure of a credit union's current and prospective earnings and capital based on changes in market prices and interest rates. Ratings of sensitivity to market risk are determined based on sensitivity of a credit union's current and future earnings and economic value of capital to negative changes in market pricing and interest rates, and management's ability to identify and control exposure to market risk and the nature and complexity of interest rate risk exposure.

Composite Rating

While the overall composite rating should bear a close relationship to the individual component ratings, it is not derived by an arithmetic equation. The examiner will consider the interrelationships among the components when assigning a composite rating. The performance and capability of management is a significant factor in the overall risk profile of a credit union and the examiner will give special consideration to the management rating when assigning the overall composite rating.

THE EXAMINATION

The goal of the examination is to evaluate the health of the credit union. It is NCUA's job to protect the NCUSIF and to ensure credit unions are operating in a safe and sound manner. Below is an overview of what to expect during an examination, but it should be noted that as part of NCUA's regulatory initiative to modernize the exam report and processes, it streamlined its examination report and provided for certain changes with the examination process. In the past few years, NCUA approved five initiatives to modernize the agency's exam processes - the Flexible Examination Pilot Program (FLEX), Office of National Examinations and Supervision (ONES) Data Driven Supervision, the Shared NCUA-State Regulator Federally Insured, State-Chartered Credit Union (FISCU) Program, the Enterprise Solution Modernization Program (ESM), and the Virtual Examination Program. In late 2021, NCUA began an industry-wide transition to the Modern Examination and Risk Identification Tool (MERIT).

MORE INFORMATION: **These changes are addressed in Letter to Credit Unions No. 13-CU-09. In 2017, NCUA made examination scheduling policy and supervision process changes for federally insured credit unions. The exam cycle changes are addressed in Letter to Credit Unions No. 16-CU-12. Information about all five examination modernization initiatives is provided in Letter to Credit Unions No. 18-CU-01. The transition to the Modern Examination and Risk Identification Tool (MERIT) is discussed in Letter to Credit Unions No. 21-CU-08.**

Credit unions sometimes feel that examiners come into the examination with preconceived ideas of the credit union's health and are just looking to buttress their preconceived notions. Hopefully, this is not true; however, examiners will likely have completed a preliminary risk assessment as part of their examination preparation. This preliminary risk assessment will focus the examination on areas of concern. During the examination, examiners will likely have discussions with management and staff as well as review the credit union's performance. An examination can last a couple of days or a couple of weeks depending on the health, size and complexity of the credit union. Once the examination is complete, the examiner(s) will meet with credit union management and write up a report.

Joint Conference/Exit Meeting

The final meeting with management is either a joint conference or an exit meeting. The joint conference is a meeting with the examiner(s) and a quorum of the credit union board of directors. A joint conference is required for credit unions with CAMELS ratings of 3, 4, or 5. A credit union with a CAMELS rating of 1 or 2 can request a joint conference. Otherwise, CAMELS 1 and 2 credit unions will have an exit meeting with the examiners. An exit meeting does not require a quorum of the board to be in attendance. Other persons besides board members that may be in attendance are senior management and key employees.

Importantly, there should be no surprises—from either side—at the final meeting. There should be open communication between the credit union and the examiner during the examination. These discussions should be reflected in the final meeting.

MORE INFORMATION: **More information on joint conferences can be found in the Team Coordination section of the Online Examiner's Guide.**

Whether it is a joint conference or an exit meeting, this final meeting provides examiners with the opportunity to discuss concerns and possible corrective action with credit union management. Management should come away from the meeting with a good indication of what the examination report will include—management should not be surprised by the report. Hopefully, examiners and management will come to agreement on future steps to take during this meeting, but if agreements cannot be made, NCUA has administrative tools it can use.

Administrative Tools

Document of Resolution (DOR). A DOR is an agreement between NCUA and the credit union. It formally documents plans for the credit union to take in order to reduce areas of unacceptable risk. Credit union officials sign the document, binding the credit union to the agreement. Officials should not sign the document if they do not agree with the examiner's plans for the credit union. If they do not sign the DOR, NCUA will expect the credit union to provide alternate plans for the credit union to enact to reduce its risk. If the credit union signs the DOR and does not come up with alternate plans, NCUA will likely take stronger administrative enforcement actions if the plan is not followed

NAFCU NOTE

Credit unions sometimes have disagreements with their examiners. NAFCU's Exam Fairness Guide contains information and resources about how to handle these disagreements.

As previously mentioned, NCUA issued Letter to Credit Unions No. 13-CU-09 to streamline the examination report. The letter also clarifies for federally insured credit unions the difference between a document of resolution and examiner findings. Processes related to issuing and following up on the examination report have also been implemented by the agency. As of January 1, 2014, examiners are required to follow up with credit union officials on outstanding DOR items within 120 days after the timeframe for completion has passed. The current processes for the examination report are contained in NCUA's National Supervision Policy Manual.

Letter of Understanding and Agreement (LUA). An LUA is issued when the credit union has not adequately responded to less severe actions, such as DORs. Like a DOR, an LUA is an agreement between the credit union and NCUA. The credit union agrees to take, or not to take, certain actions specified in the LUA. It is stronger than a DOR in that NCUA may enforce violations of an LUA through other administrative action (i.e., a Cease and Desist Order or Civil Money Penalty).

Cease and Desist Orders (CDOs). A CDO is similar to an injunction and is usually NCUA's first step when it needs formal action. An examiner can recommend a CDO when the credit union has engaged or is about to engage in unsafe/unsound practices, violations of rule or law, or violation of any conditions imposed by NCUA in writing.

The credit union will first receive a Notice of Charges. The credit union may either consent to the charges, or it may contest them in an administrative hearing. If the credit union does not contest the charges, NCUA will issue a final CDO. If it contests them, an administrative judge will preside over the hearing and make a recommended decision. Once the NCUA Board receives the recommended decision, it must make its final decision within 90 days. A final CDO will then be issued.
A Temporary CDO will occasionally accompany the Notice of Charges when NCUA believes immediate action is necessary. The temporary order is effective immediately upon service and remains effective through the administrative proceedings.

Other Powers. NCUA has other powers as well, such as issuing civil money penalties, issuing prohibition orders and removing credit union officials.

Formal Appeals. If the credit union is not satisfied with NCUA actions and informal conversations fail to resolve disagreements, the credit union does have formal appeal rights.

MORE INFORMATION: Credit unions looking for more information about how NCUA examinations should be conducted can review the National Supervision Policy Manual.

SUPERVISORY FOCUS

NCUA issues a Letter to Credit Unions regarding its exam focus at the beginning of each calendar year. Credit unions would be wise to read this letter and prepare for NCUA to emphasize those areas in upcoming exams.

Letter to Credit Unions 23-CU-01 describes NCUA's Supervisory Priorities for 2023. Similar to previous years, NCUA continues to list credit risk management and cybersecurity as priorities. Other 2023 priorities include the implementation of the current expected credit losses (CECL) accounting standard, consumer financial protection areas such fair lending and overdraft programs, fraud prevention and detection, and interest rate and liquidity risk. NCUA highlights credit risk management as a repeat priority for the Administration with a focus on lending programs in light of the high inflation and rising interest rates. NCUA also introduced succession planning and support for small credit unions and minority and depository institutions as two new priorities for the Administration in 2023. NCUA reminds credit unions to provide feedback via its post-examination survey, and that credit unions may record their exit meetings provided they comply with applicable laws and regulations for recording and provide a copy to NCUA. Finally, NCUA removed its BSA/AML focus in favor of targeting fraud prevention and detection, with a newly implemented questionnaire via MERIT's survey function, designed to enhance the identification of fraud red flags, material supervisory concerns, or other potential new risks to which a credit union may be exposed.

CHAPTER 1 — FUNDAMENTALS

SECTION 5 — FEDERAL CREDIT UNION GOVERNANCE

FEDERAL CREDIT UNION BYLAWS

The bylaws act as the contract between the federal credit union and its members. They define the rights and responsibilities of the federal credit union and the members in relation to each other.

The bylaws were deregulated in the 1980's but were placed back into NCUA's regulations in section 701.2 in 2007. NCUA's rationale for reintegrating them into its regulations was to clarify NCUA's enforcement authority of the bylaws. When the bylaws were deregulated, members often had to attempt to enforce their rights through the various state court systems, with outcomes varying widely. NCUA determined that, in order to enforce the bylaws, the agency needed to reincorporate the bylaws into its rules and regulations. In the preamble to the 2007 model bylaws, NCUA explained that the agency's involvement is limited to situations where the violation threatens a "fundamental, material credit union member right, including the right to maintain a share account, maintain credit union membership, have access to credit union facilities, participate in the director election process, attend annual and special meetings, and petition for removal of directors and committee members." NCUA still expects credit unions and members to resolve their differences internally; however, NCUA wanted more leverage to enforce the bylaws when the parties found themselves unable to resolve the issues at hand.

NCUA provides model bylaws for federal credit unions at Appendix A to Part 701. The model bylaws are updated from time to time. When NCUA issues a new version of the model bylaws, federal credit unions are encouraged, but not required, to adopt the new version in its entirety as the new version often provides greater clarity and flexibility. Federal credit unions may choose to adopt the new version in its entirety, adopt some of the new provisions or adopt none of them. As a result, each federal credit union may have its own unique version of the bylaws. It is important to start by reviewing your own bylaws when researching bylaws issues.

NAFCU NOTE

In 2022, the Credit Union Governance Modernization Act (CUGMA) was signed into law, but it will not affect credit unions until NCUA adopts its regulations. CUGMA expands credit unions ability to expel members for cause. NAFCU published this *Compliance Blog* post detailing this pending expulsion power.

Confidentiality

Article XVI of the model bylaws requires all officers, directors, committee members and employees to hold in confidence all member information and transactions. Information should be shared only in accordance with state and federal law.

Records

Copies of official documents (bylaws, charter, meeting minutes, etc.) must be kept on file at the federal credit union under Article XVI of the model bylaws. Directors and committee members must have access to the records provided they have a proper purpose. Members have the duty to keep the credit union informed of their current address and, if they elected to received electronic communications, e-mail address.

Indemnification

Article XVI of the model bylaws allows federal credit unions to indemnify current or former officials and employees. Indemnification may extend to any liability asserted against them or any expenses reasonably incurred by them in connection with proceedings against them in relation to the performance of their official duties. Any indemnification provided must comply with the limitations outlined in section 701.33(c). For purposes of indemnification, an "official" includes directors and all committee members.

Bylaw Amendments

Certain amendments require only board approval while other changes require NCUA approval. Where the model bylaws permit federal credit unions to select an option, range of options or fill-in-the-blank, changing to a different permissible option requires only a two-thirds vote of the board. The change is effective upon board approval. Adopting new provisions of the model bylaws can also be accomplished with board approval, as long as the provision is being adopted verbatim. All other changes require NCUA approval. A request to amend the bylaws must be submitted to the Office of Credit Union Resources and Expansion (CURE). The request must include the section of bylaws the federal credit union wants to amend, the reason or purpose of the amendment, an explanation of why the amendment is desirable and what it will the federal credit union accomplish and the proposed wording of the amendment. CURE will notify the federal credit union within 60 days of its decision to approve or deny the request.

RESEARCH TIP: In the past, NCUA issued letters indicating the permissibility of bylaw amendments requested by credit unions. These can be accessed on NCUA's website under the "subject" down arrow and can provide helpful analysis when researching a bylaws issue. Credit unions with a specific bylaw request should contact CURE at dcamail@ncua.gov and follow NCUA's outline to request the amendment.

FEDERAL CREDIT UNION MEMBERSHIP

Federal credit unions are owned by their members rather than by a small group of persons or shareholders. The benefits of membership flow back to the members in the form of lower (and fewer) fees than other financial institutions. This also stems from the credit union ownership structure and the lack of shareholders seeking a return on their investment.

Members exercise democratic control of the credit union by attending regular and special meetings, electing the board of directors and inspecting the federal credit union's books and records. Each member has only one vote regardless of the number of shares held at the federal credit union. This ensures each member has a say in the overall direction of the credit union.

Membership Qualifications

Article II of the model bylaws outlines the basic qualifications for membership in the federal credit union. The consumer or business must be within the federal credit union's field of membership, as stated in Section 5 of its charter. An application for membership, signed by the applicant, must be submitted. The application is either approved or denied by a membership officer. Federal credit unions must provide a written explanation of the reason for denying a membership application only if the applicant makes a written request for such an explanation.

If the application is approved, the applicant becomes a member once they purchase par value and, if required, pay an entrance fee. Any entrance fee must be uniform for all classes of members.

NAFCU NOTE

Credit unions are increasingly allowing consumers and businesses to apply for membership online. This NAFCU *Compliance Blog* post explains the permissibility of online membership applications.

Par Value and Shares

The amount of the par value required for membership is stated in Article III of the model bylaws. Different par values may be established for different classes of members, as long as each value is stated in the bylaws. The bylaws provide new members with a certain amount of time to purchase par value. Failure to do so within the allotted time terminates the membership.

For joint accounts, federal credit unions have two options. First, they can choose to require each member to have his or her own individual account. In this situation, each member would need to fulfill the membership requirements, including keeping the par value in their individual account. Alternatively, they can choose to allow two members to open a joint account without requiring individual accounts. Under this option, each member's par value would be held in the joint account. For example, if par value was $5, the federal credit union would hold $10 in the one account. The bylaws will indicate which option the federal credit union has chosen.

Par value must be maintained to remain a member of the federal credit union. In the event the account balance falls below par value (including falling to zero or to a negative balance involuntarily), Article III provides an existing member a certain amount of time to bring his or her account back to par value. Historically, NCUA had included "six months" as this time period, but the current version of the model bylaws leaves this as a fill-in-the-blank option for the credit union. The agency has indicated the option selected by the credit union must be reasonable. If the member does not return the account balance back up to or above par value within the provided time period, the individual ceases to be a member.

NCUA has also indicated in past legal opinion letters that members should be aware of the possibility of their membership being terminated due to the failure to reestablish par value. The agency indicates that while notification to a member is not necessary each time a member's account is reduced below par value, members should be aware of the credit union's policy of closing accounts when the balance remains below the credit union's par value.

NAFCU NOTE

For some frequently asked questions related to par value, check out this NAFCU *Compliance Blog* post.

Article II covers situations where a member voluntarily withdraws all their funds, closes their accounts and terminates membership. After a member has terminated their membership, they must reapply to become a member again.

Article III of the model bylaws allows the board to establish a maximum amount of shares that any one member may hold and to place restrictions on transferring and withdrawing shares. The board also has the ability to require members to provide up to 60 days written notice of a member's intention to withdraw all or part of his or her shares.

Once a Member, Always a Member

Federal credit unions operate under the policy of "once a member, always a member." Such a policy provides that even if a person exits the field of membership, they may continue as a member until their membership is voluntarily terminated or they are expelled from membership. The once a member, always a member credo is spelled out in Article II of the model bylaws.

The once a member, always a member policy does not prevent a federal credit union from limiting the services of certain members. Members in good standing retain all membership rights and access to all credit union services. A member in good standing must maintain par value, not be significantly delinquent on loans, have no accounts closed due to abuse or negligence, have not caused a loss to the federal credit union and not engage in violent, belligerent, disruptive or abusive activities. For members not in good standing, federal credit unions may limit services in accordance with a limitation of services policy that has been adopted by the board and previously distributed to members.

Voting

Members are responsible for selecting a federal credit union's board of directors. The board of directors is responsible for establishing and guiding the credit union's strategic plan to accomplish its mission. If members do not like the direction the credit union is going, they can speak with their vote at the next annual election.

Under Article XVI of the model bylaws, members may also, by majority vote, remove any director or committee member at a special meeting called for that purpose. The director or committee member must be given an opportunity to be heard at the meeting. If members vote to remove all the directors, the supervisory committee immediately steps in as the temporary board until a new board is elected at a subsequent special meeting.

Inspection of Books and Records

Article XVI of the model bylaws gives members the right to inspect the bylaws and charter at any time and members can request either physical or electronic copies of those documents. The credit union may charge a reasonable fee for providing physical copies. This section of the bylaws also requires federal credit unions to post the bylaws on its website if it maintains one.

Under section 701.3, members have the right, upon submission of a petition, to inspect a federal credit union's books and records, including the board's minutes, after confidential information has been redacted and subject to NCUA's regulation that governs member access to records. The request must be made in good faith and for a proper purpose, such as examining the financial condition of the credit union or determining how the credit union is being operated and the direction it is taking.

MORE INFORMATION: NCUA states in Legal Opinion Letter 92-0101 **credit union members have inspection rights similar to the rights of shareholders of a corporation. However, the credit union board should redact all personal and confidential information before sharing records.**

Meetings of Members

Meetings are another way members exercise control over the credit union. Directors are elected at the annual meeting and special meetings can be held to consider items such as expulsion of members and regulatory violations.

When conducting meetings, Article IV of the model bylaws direct the credit union to choose an authority it will follow, such as Robert's Rules of Order. This is because the bylaws do not answer every procedural question and often questions and issues arise in the course of elections and other items of business at meetings. If the federal credit union has a consistent source to turn to when it has such questions, the preparation and execution of the meetings will run more smoothly.

For both annual and special meetings, the commentary to the model bylaws encourages federal credit unions that maintain a website to provide a live webcast or post a video of the meeting on the federal credit union's website. This allows all members an opportunity to participate and remain interested in the affairs of the federal credit union.

Annual Meetings

Article IV of the model bylaws requires federal credit unions to hold an annual meeting. The model bylaws also provide the timing of the meeting (i.e., the general time of the year it will be held, such as "during the month of March").

Written notice of the annual meeting must be provided to the membership 30-75 days prior to the meeting. Notices may be given in person, by mail or electronically to members who have elected to receive statements and notices electronically. Notice of the annual meeting must be placed in the federal credit union's office and on the credit union's website, if it maintains one.

A quorum is required to conduct the annual meeting. Fifteen members constitute a quorum.

MORE INFORMATION: In Letters to Federal Credit Unions 20-FCU-02 and 20-FCU-04, NCUA provides a new bylaw amendment. NCUA recently extended its annual meeting flexibility into 2022 with a Letter to Federal Credit Unions 21-FCU-06. By adopting the amendment, a federal credit union may hold its annual meetings and the required in-person board of directors meeting in an entirely virtual format if certain circumstances are present, such as a state of emergency.

Special Meetings

Special meetings can be called by the chair of the board, majority vote of the board, the supervisory committee or the members. In order to call a special meeting, members must have signatures from 25 members or 5 percent of the membership, whichever is larger, but not more than 750 signatures can be required.

Written notice of a special meeting must be provided at least 7 days prior to the meeting. Notices may be given in person, by mail or electronically to members who have elected to receive statements and notices electronically. The notice must state the purpose of the meeting and no other business may be conducted at the meeting.

A quorum is also required in order to conduct a special meeting. Fifteen members constitute a quorum.

BOARD OF DIRECTORS

The board must consist of an odd number of 5-15 directors. Article VI of the model bylaws states the specific number of directors. By resolution of the board, the number may change, provided that no reduction in number will be made unless corresponding vacancies exist. Employees may serve on the board, if the federal credit union so provides in its bylaws; however, they cannot constitute a majority of the board. The federal credit union can also determine whether to permit the management official (i.e., CEO, President or Manager) and any assistant management officials to serve on the board. If so, they may not serve as the chair.

NAFCU NOTE

Credit unions looking for more information or research on issues related to the board might find the NAFCU *Compliance Blog* posts regarding boards and governance to be helpful.

Board terms will be two or three years and must be the same for each office. If a vacancy occurs, the board will fill it by majority vote. The appointed director serves until the next regularly scheduled election. If, at the time of the next annual meeting, there are additional years remaining on the vacancy, the credit union members will elect a replacement and the appointed director will serve until the appointment and qualification of the elected replacement.

Elections

Under the FCU Act, there can only be three eligibility requirements to run for the board:

1. The individual must be a member before distribution of ballots;
2. The individual cannot have been convicted of a crime of dishonesty or breach of trust; and
3. The individual must meet any minimum age requirement provided in the bylaws (if any), which cannot be greater than the age of majority under the applicable state law.

Any individual meeting these three criteria may run for the board.

The board is elected by the federal credit union's members. Members have one vote, irrespective of the number of shares, and cannot vote by proxy. Federal credit unions may choose to allow absentee ballots. Candidates are elected by plurality vote.

Article V of the model bylaws provide four elections options from which a federal credit union can choose for electing the board of directors. The bylaws will only have one of these four options:

1. In person voting with nominations from the floor and nominating committee;
2. In person voting with nominations by petition and nominating committee;
3. Voting by ballot boxes/voting machine with nominations by petition and nominating committee; or
4. Voting by electronic device and mail with nominations by petition and nominating committee.

Each option provides for a nominating committee. A nominating committee is appointed before the annual meeting and is tasked with the duty of nominating at least one eligible and willing candidate for each vacant position. The nominations are filed with the secretary who sends notifications of the annual meeting. The actual voting procedures depend on the election option chosen by the credit union.

The nominating committee must ensure that any candidate it nominates meets the three eligibility requirements. The board and nominating committee may adopt a policy establishing additional reasonable criteria, such as financial expertise or term limits. These additional criteria only apply to the individuals nominated by the committee. Individuals nominated from the floor or by petition—depending on the credit union's election option—are not restricted by additional criteria.

Board Officers and Committees

After the annual meeting, the board meets to elect the board officers that will serve for the next year. The elected officers will serve until the next annual meeting and subsequent election of board officers. Board officers include a chair, one or more vice chairs, a financial officer and a secretary.

The commentary to the model bylaws clarifies the board may also consist of director emeritus and associate director positions. These are general advisory roles whereby individuals may assist the credit union during board meetings and other tasks but may not vote.

NAFCU NOTE

This NAFCU *Compliance Blog* post outlines the functions of committees formed to assist the board in carrying out its duties, and explains whether each committee is required or optional.

Article VII of the model bylaws outlines the duties of the various board officers. The chair presides over board meetings and performs other duties customarily assigned to the chair. The vice chair fills in when the chair is absent or unable to fulfill his or her duties. The bylaws provide numerous duties for the financial officer, including posting monthly financial statements in the federal credit union's office, having custody over all federal credit union assets and hiring employees. However, any and all of these duties may be delegated to the CEO (or President or Manager). Most boards will delegate much of the daily operations to the CEO and his or her staff. The board will generally not be involved in the hiring process of all employees, although it does hire the CEO. The secretary provides proper notice of meetings of the members, takes meeting minutes and maintains complete board records.

The board may establish executive and investment committees. The executive committee is made up of at least three directors and can act for the board within the purview of its delegated authority. The delegations cannot be broad. The board must be specific with regard to the responsibilities it delegates to the committee and with any limitations on the committee's authority. The executive committee must take minutes and keep records of its meetings. The investment committee is made up of at least two directors and is responsible for making investments under procedures established by the board.

Meetings of the Board

Article VI of the model bylaws requires the board to hold regular meetings at least once a month. At least one regular meeting each year must be held in person. The in-person meeting must include a quorum of the board, while the rest of the directors may participate through a teleconference option without failing to meet the requirement to have an in-person meeting. The rest of the regular meetings may be conducted using audio or video teleconference methods. Special meetings may be called by the chair and must be called when a majority of the directors make a written request for a special meeting. Special meetings may be conducted using audio or video teleconference methods.

RESEARCH TIP: NCUA has a few legal opinion letters regarding board meetings and acceptable bylaw amendments. For example, the model bylaws require one board meeting per year to be in person, but a credit union could require all board meetings to be in person.

A quorum is required in order to conduct business at meetings. A majority of board members, including any vacant positions, constitutes a quorum. Minutes of all meetings must be recorded and retained. Minutes must be signed by the chair and secretary.

Board Responsibilities

The board is tasked with the general direction and control of the federal credit union and should be involved in all major decisions. This generally means that the board sets the broad goals and vision of the federal credit union, often called "strategic planning." Additionally, Article VI of the model bylaws maintain the following specific duties:

- Directing the affairs of the federal credit union in accordance with laws and regulations, the bylaws and sound business practices;
- Establishing programs to achieve the federal credit union's purpose;
- Establishing lending policies and a loan collection and charge-off program;
- Requiring board and volunteer training to include ethics and fiduciary responsibility, regulatory compliance and accounting; and
- Performing additional acts and exercising additional powers as may be required or authorized by law.

The board is authorized to establish dividend periods and declare dividends. According to NCUA Legal Opinion Letter 01-0344, the board may delegate its duty to set dividend rates to a committee of senior management officials, within limits. The board must establish a range of rates for each type of share account and the committee may adjust rates only within that established range. For loans, the board of directors may determine a late charge that will be assessed to members that are delinquent on their loans.

The board may remove directors or credit committee members if they miss too many meetings or if they otherwise fail to perform their duties. The board may also suspend any supervisory committee member by majority vote; the membership will then decide at a special meeting whether the committee member will be removed from or restored to office.

RESEARCH TIP: Credit unions can find more on board and senior management responsibilities in Chapter 7 of NCUA's former PDF Examiner's Guide. The Online Examiner's Guide is updated on a rolling basis, and this section is currently in development.

Fiduciary Duties

Article XVI of the model bylaws prohibits conflicts of interest. The bylaws state directors must not participate in any manner with a decision that affects their own personal interest or the interests of any business they are involved in. This means that the director must withdraw from all deliberations and voting.

Section 701.4 of NCUA's regulations requires each director to act in good faith and in the best interest of the credit union membership when carrying out their duties. Each director must set aside his or her own needs for the needs of the credit union membership and manage the credit union for the benefit of the members. In the preamble to a 2010 final rule, NCUA stated the interests of the membership as a whole must be considered when making decisions. This is even more important when decisions affect a member's fundamental rights, such as when the directors are considering a merger.

The rule also requires directors to ensure they have all material information before making a decision. While exactly what this requires will vary from state to state, NCUA has referred to a Delaware case that provided some factors to consider: the amount of time spent preparing for the decision, including researching and investigating the information; the thoroughness of deliberations; whether outside guidance was obtained and whether alternatives were considered.

Both section 701.4 and Article VI of the model bylaws require directors to receive training on certain aspects of credit union operations. The rule explains directors have six months from the date they take office to obtain a "working familiarity" with finance and accounting practices to enable them to read a balance sheet and income statement and ask appropriate questions of management and auditors. The model bylaws further explain that training must also include ethics, fiduciary responsibilities and regulatory compliance.

Section 701.4 also explains directors are not meant to be experts on every topic and may rely on others to assist them in the decision-making process. The board may retain specialized staff, counsel, advisors or other consultants. When it comes to credit union staff, the board may require staff to report directly to the board as appropriate. The preamble to the 2010 final rule notes that requiring staff to report directly to the board will allow the board to bypass the CEO to obtain information from staff, but it does not allow the board to bypass the CEO to give direction to staff. This supports a previous NCUA opinion that the board must be allowed to obtain information from any source.

Section 701.4 states directors may also rely on the information, opinions, reports and financial statements presented by staff and outside consultants if the director reasonably believes that the information presented is within that person's expertise. A director must act with reasonable care in determining whether it is appropriate to rely on the information. In a 2010 notice of proposed rulemaking, NCUA opined a director should evaluate the person's competence on the matter at hand, considering their education and experience; to assess the person's reliability, including any conflicts of interest; and to have actually read all the information or to have been present at the meeting where the information was presented. If the director has knowledge that would make reliance unwarranted, the director must not rely on the information presented.

Compensation

Under the FCU Act, only one board officer may be compensated for his or her duties. Article VII, Section 1 of the model bylaws allows credit unions to write in which officer, if any, may be compensated. The remaining directors and committee members must be volunteers and must not be compensated for performing their duties as officials of the federal credit union. However, federal credit unions may, within the limitations provided in section 701.33, reimburse directors for reasonable costs incurred in performance of their duties, provide health, accident, and related types of personal insurance and indemnify them in connection with administrative and judicial proceedings.

Reasonable Costs

Section 701.33(b)(2)(i) permits a federal credit union to reimburse its directors for reasonable expenses incurred while performing their duties. This may include training and travel costs including the travel costs of one guest. If training sessions involve travel and the director brings a guest for whom the credit union reimburses travel costs, the director may have to report the reimbursement as income for tax purposes, according to Letter to Federal Credit Unions 05-FCU-02. The board of directors must establish policies and procedures that include documentation requirements for reimbursement and determine what costs are reasonable, necessary and appropriate.

NAFCU NOTE

This NAFCU *Compliance Blog* post covers reimbursement of director expenses, and reviews several NCUA legal opinion letters on whether certain expenses may be reimbursed,

Health Insurance

A federal credit union may provide directors with reasonable health insurance. Section 701.33(b)(2)(ii) indicates that any insurance provided must be limited to areas of risk to which the official is exposed by reason of carrying out the duties or responsibilities of the office.

However, in a legal opinion letter, NCUA noted that it would be, from a practical standpoint, likely impossible to limit healthcare coverage to only credit union activity. Thus, a federal credit union does not have to limit healthcare coverage to risks associated with the official's credit union activities. Although there are federal and state laws that entitle directors to maintain health insurance at their own expense, any insurance coverage provided by the credit union to directors must cease when they leave office.

The federal credit union may purchase insurance coverage directly for directors or may choose to reimburse them for their actual costs in obtaining coverage. If the federal credit union permits directors to obtain their own insurance, it must establish written policies and procedures that include limits and documentation requirements to ensure that the credit union is not compensating the officials in any manner. If a director already receives insurance without out-of-pocket expenses, the credit union may not provide payment to the director for the benefit's value as this would result in compensation.

Indemnification

Section 701.33(c) states that a federal credit union may indemnify its directors (as well as current and former employees) for costs reasonably incurred in association with judicial or administrative proceedings. If the federal credit union chooses to do so, it must do so in accordance with standards established by the state where the federal credit union's principal or home office is located or by the Model Business Corporation Act. Article XVI of the model bylaws states which law applies. Additionally, a federal credit union may purchase insurance to cover directors and employees against any liability claims arising out of their work for the credit union.

NCUA does not permit indemnification of officials for egregious violations of their fiduciary duties. Thus, a federal credit union may not indemnify an official for personal liability related to a matter significantly affecting the members' fundamental rights and interests if a court determined that the decision made by the official amounted to gross negligence, recklessness or willful misconduct. Matters affecting the fundamental rights and interests of members include charter and share insurance conversions and terminations.

CREDIT COMMITTEE

Federal credit unions must make a decision on whether or not to have a credit committee. Article VIII of the model bylaws provides two options.

If a federal credit union chooses to have a credit committee, the committee must consist of an odd number of 3-7 members. The committee members are either elected by the federal credit union members or appointed by the board. The credit committee reviews and acts upon loan applications. It may appoint one or more loan officers and delegate the power to approve loans. Loans not approved by a loan officer must be reviewed by the credit committee.

If a federal credit union chooses to have no credit committee, the board appoints one or more loan officers to provide the same function as a credit committee. A member has the right to appeal to the board for a review of a loan denied by a loan officer. The board may also appoint a loan review committee that serves as a mid-level review.

SUPERVISORY COMMITTEE

The FCU Act requires every federal credit union to have a supervisory committee. The supervisory committee is composed of 3-5 members who are appointed by the board. One board member, other than the financial officer or the compensated director (if there is one), may serve on the supervisory committee. Members of the credit committee (if one exists) and employees cannot serve on the supervisory committee. These limitations are in place due to the role of the supervisory committee as an audit arm of the federal credit union and the need for independence. Committee terms are 1, 2 or 3 years, as determined by the board.

RESEARCH TIP: **Information on the supervisory committee's responsibilities can be found in Chapter 5 of NCUA's Examiner's Guide. Additionally, NCUA has added Appendix A to Part 715 and published a manual on the topic, both of which detail the minimum procedures for the supervisory committee audit.**

Article IX of the model bylaws outlines the various responsibilities of the supervisory committee. The supervisory committee acts as the watchdog of the federal credit union and conducts annual audits and verification of accounts. The committee should review the performance of the federal credit union, its officials and employees and make recommendations to the board for improvements that can be made. The supervisory committee may employ certified public accountants and/or other independent qualified persons to assist in its audit, account verification and clerical duties. In addition, if the full board of directors is removed simultaneously, the supervisory committee fills in until a special meeting is called to elect board members who will serve until the next annual meeting.

The supervisory committee may suspend any director, board officer or member of the credit committee until the next meeting of the members. The vote must be unanimous. The supervisory committee must then call a special meeting of the members to act on the suspension. The special meeting must be held 7-14 days after the suspension.

Further, by majority vote, the supervisory committee can call a special meeting of the members to consider any violations of the FCU Act, regulations, the federal credit union's charter and bylaws or to consider any acts it deems to be unsafe or unauthorized.

CHAPTER 1 — FUNDAMENTALS

SECTION 6 — FEDERAL CREDIT UNION POWERS AND LIMITATIONS

FEDERAL CREDIT UNION POWERS

The Federal Credit Union Act (FCU Act) gives credit unions the legal authority to perform certain acts and activities, which are often referred to as the federal credit union's powers. The FCU Act explicitly describes several express powers and permits federal credit unions to exercise such incidental powers as are necessary or requisite to carry on their business. NCUA details which incidental powers federal credit unions have in Part 721 of its rules and regulations. In general, if an activity is not expressly stated in the FCU Act and it is not an incidental power, a federal credit union may not engage in the activity.

It is important to note that although state-chartered credit unions are not created under the Federal Credit Union Act, many states have taken language directly from the Act in creating state credit union systems. Therefore, it is not unusual for state-chartered credit unions to have an almost identical set of powers.

Express Powers

The FCU Act provides a long laundry list of express powers in which federal credit unions may engage. These express powers are as follows:

- To make contracts;
- To sue and be sued;
- To adopt and use a common seal (and to alter it);
- To purchase, hold, and dispose of credit union property;
- To make loans to its members;
- To make participation loans with other credit unions, credit union organizations and other financial institutions;
- To receive shares from its members, other credit unions, certain political and governmental entities, the central liquidity fund, and from nonmembers in the case of low-income credit unions;
- To invest its funds in permissible investments;
- To deposit its funds in other U.S. financial institutions;
- To borrow funds (not to exceed 50 percent of its paid-in and unimpaired capital and surplus);
- To levy late charges on delinquent loan payments;
- To impress a lien on member shares and dividends to the extent any loan or dues and charges are payable by a member;
- To sell negotiable checks, traveler's checks, money orders, and other similar money transfer instruments to, and to cash checks and money orders for members and nonmembers within the credit union's field of membership, for a fee;

- To purchase, sell, pledge or discount eligible obligations of its members in an amount not to exceed 5 percent of its unimpaired capital and surplus;
- To sell all or part of its assets to another credit union, to purchase all or part of the assets of another credit union, and to assume the liabilities of the selling credit union and those of its members;
- To invest in certain securities;
- To provide technical assistance to credit unions in Poland and Hungary, subject to any NCUA regulations; and
- To exercise such incidental powers as may be necessary or requisite to enable to carry on effectively its ordinary business.

Incidental Powers

As indicated above, the last power expressed in the FCU Act is the power to "exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated." NCUA has provided a preapproved list of activities that are incidental powers.

RESEARCH TIP: NCUA has issued several legal opinion letters regarding incidental powers activities, including Legal Opinion Letters 09-1021 regarding mortgage processing and services; 03-0308 regarding financial counseling and investment advice; 03-0908 regarding payroll cards; 92-0908 regarding political activities; 04-0223 regarding charitable contributions and 04-0133 regarding charitable foundations. Additional opinions can be found through NCUA's search function.

If a federal credit union wants to engage in an activity that is not listed as an express power or one of these preapproved activities, it can apply to NCUA to have the activity approved as an incidental power. Section 721.4(c) provides the following three-prong test NCUA will use to determine if an activity meets the definition of an incidental power:

1. Whether the activity is convenient or useful in carrying out the mission or business of federal credit unions consistent with the FCU Act;
2. Whether the activity is the functional equivalent or logical outgrowth of activities that are part of the mission or business of federal credit unions; and
3. Whether the activity involves risks similar in nature to those already assumed as part of the business of federal credit unions.

The rule does specify that federal credit unions can earn income from activities that are deemed to be incidental powers.

Preapproved Categories

NCUA's incidental powers regulation contains preapproved categories of activities that are incidental powers. These preapproved activities are as follows:

Certification Services. Federal credit unions engage in certification services when they attest or authenticate a fact for their members' use. Common examples are notary services, signature guarantees, certification of electronic signatures and share draft certifications.

Charitable Donation Accounts. A charitable donation account (CDA) is defined as a hybrid charitable investment vehicle that facilitates the charitable activities of federal credit unions by allowing for investments with a higher expected return, within the safe and sound parameters the rule establishes. Federal credit unions may make charitable contributions and donations to the community where they meet a certain set of requirements and are deemed necessary or requisite to enabling the credit union to effectively carry on its business. Charitable contributions and donations are gifts a federal credit union provides to assist others through contributions of staff, equipment, money, or other resources. Examples of charitable contributions include donations to community groups, nonprofit organizations, other credit unions or credit union affiliated causes, political donations and donations to create charitable foundations.

Correspondent Services. Federal credit unions may provide services to other credit unions as long as the federal credit union is authorized to provide those services to its own members or as a part of its operations. Such services may include cashing and selling money orders, receiving share and loan payments, cashing share drafts, processing loans and other back-office operations or member services.

Parties to a correspondent services arrangement must establish a written agreement. The agreement must outline the credit unions' responsibilities under the service arrangement.

Electronic Financial Services. If a federal credit union is authorized to provide a service or product, it may do so through electronic means. Electronic services can include electronic funds transfers, online transaction processing, account aggregation services and website hosting services.

Excess Capacity. Excess capacity is the excess use or capacity remaining in facilities, equipment or services. The sale or lease of excess capacity is within a federal credit union's incidental powers provided that: 1) the federal credit union properly established the service or made the investment with the good faith intent of serving its members; and 2) it reasonably anticipates that the excess capacity will be used in future expansion of services to its members.

Financial Counseling Services. Financial counseling is a part of providing credit and savings opportunities for members and part of the credit union business. Federal credit unions may provide such services as estate planning, income tax preparation and filing, and investment and retirement counseling. This category does not encompass activities that require SEC registration as a broker, dealer or investment adviser.

Finder Activities. Federal credit unions are authorized to bring together outside vendors with their members for the negotiation and consummation of transactions. The federal credit union acts as "finder" by identifying outside parties in which it believes its members would be interested. The third parties can include vendors of financial products as well as non-financial products and other financial institutions. Examples of finder activities are negotiating group discounts on behalf of the members and placing vendor advertisements in newsletters and as statement stuffers.

Loan-Related Products. This category encompasses activities, services and products a federal credit union may engage in and provide to its members that are incidental to its express authority to lend to its members. These products may include debt suspension agreements, debt cancellation agreements, leases and letters of credit.

Marketing Activities. Federal credit unions may use this power to market membership in the credit union as well as to advertise their products and services. Raffles, membership referral drives and advertisements are classic examples of the exercise of this authority. NCUA has also issued a couple of legal opinion letters which indicate this power may be used to offer services to nonmembers in a limited and controlled manner in order to promote membership in the credit union.

MORE INFORMATION: **NCUA's Legal Opinion Letters 02-0250 and 10-0756 discuss offering limited services to nonmembers as a form of marketing to the wider community.**

Monetary Instrument Services. Monetary instrument services are services that enable members to purchase, sell or exchange various currencies and may include the sale and exchange of foreign currency and U.S. commemorative coins. Federal credit unions may maintain accounts in foreign financial institutions to facilitate member transactions.

Operational Programs. Operational programs are programs that a federal credit union establishes to promote safe and sound operation and deliver products and services to members. A few examples include remote tellers, debit cards, payroll deduction and services, direct deposit, lock box accounting services and savings bond purchases and redemptions.

Stored Value Products. Stored value products are similar in function to traditional banking services, but the medium is different. As with traditional banking, the credit union acts as an intermediary between the member and the merchant. But instead of checks, the products include stored value cards (such as prepaid cards), tickets, postage stamps and gift certificates.

Trustee or Custodial Services. Federal credit unions do not have express trust powers, but may serve as trustees or custodians where that authority has been granted under other provisions of law. Examples include powers granted by the Internal Revenue Code to act as a trustee or custodian for member retirement, education and health savings accounts.

Impermissible Activities. As an example of the types of activities federal credit unions may not engage in, NCUA has long held that credit unions have no authority to engage in the business of insurance. Insurance involves additional risks rather than risks similar to the business of banking that federal credit unions have already assumed. They can, however, bring together outside insurance vendors with their members as a finder activity.

Asset Securitization

NCUA permits federal credit unions to issue certain securities as an incidental power. While NCUA has not formally amended the incidental powers rule to list asset securitization as a "preapproved" incidental power, it did issue Legal Opinion Letter 17-0670 on the topic and noted that in order to participate in this activity, a federal credit union would need to submit an application to the agency as addressed in section 721.4.

MORE INFORMATION: **For more information on how NCUA determines whether a federal credit union is operating within its power, credit unions may review Chapter 32 of Examiner's Guide.**

PREEMPTION

Preemption is the legal concept that, in certain situations, federal law overrides or "trumps" state law that addresses the same issue. This could occur if the FCU Act and NCUA's regulations conflict with state or local laws.

Federal credit unions generally need to comply with state law. NCUA is not aggressive in preempting state law and only explicitly preempts state law in lending and deposit-taking activities. In other areas, most federal regulations will preempt inconsistent state laws, but only to the point that they are inconsistent. Generally, if a state law is more protective of the consumer, it will not be considered inconsistent.

Lending

NCUA's lending regulation formally outlines NCUA's exclusive authority to regulate the rates, terms of repayment and other conditions of federal credit union loans and lines of credit. Under section 701.21(b), NCUA preempts state laws that regulate the rates, terms of repayment and other conditions of federal credit union loans and lines of credit including:

- Rates of interest and amounts of finance charges, including:
  - The frequency or the increments by which a variable interest rate may be changed;
  - The index to which a variable interest rate may be tied;
  - The manner or timing of notifying the borrower of a change in interest rate; and
  - The authority to increase the interest rate on an existing balance.
  - Late charges;
  - Closing costs, application, origination or other fees;
- Terms of repayment, including:
  - The maturity of loans and lines of credit;
  - The amount, uniformity and frequency of payments, including the accrual of unpaid interest if payments are insufficient to pay all interest due;
  - Balloon payments; and
  - Prepayment limits.
- Conditions related to:
  - The amount of the loan or line of credit;
  - The purpose of the loan or line of credit;
  - The type or amount of security and the relation of the value of the security to the amount of the loan or line of credit;

- Eligible borrowers; and
- The imposition and enforcement of liens on the shares of borrowers and accommodation parties.

NCUA does not preempt state laws in the areas of lending that do not affect the terms and conditions of the loan itself. For example: insurance laws; laws related to transfer of property; security interests in property; conditions of default and collection costs and attorneys' fees are historically governed by state law. Normally, state laws in these areas would not be preempted. Also keep in mind that other federal regulations, such as Regulation Z, may govern specific areas of lending.

An NCUA legal opinion letter from 2007 provides a good example of the distinction between the types of state law this rule would and would not preempt. The letter addresses a California law which requires a creditor to deliver a detailed notice to the borrower of its intent to dispose of a repossessed automobile. At the outset it would seem that this law is of a type not typically preempted by NCUA as it seems to govern default and repossession – areas of law historically governed by states and not preempted by NCUA.

RESEARCH TIP: NCUA has issued several other legal opinion letters addressing specific state laws, including Legal Opinion Letters 02-0638 regarding California credit card disclosures; 02-0827 regarding a Connecticut law that prohibits accessing a HELOC with a card; 92-1131 regarding a Pennsylvania law on mortgage fees; 02-0566 regarding the North Carolina Mortgage Lending Act; and 02-0649 regarding the Georgia Fair Lending Act. Additional opinions can be found through NCUA's search function.

However, the penalty for not providing the notice to the borrower as required by the state statute does affect the terms of repayment, as failure on the creditor's part to comply destroys the creditor's ability to recover from the borrower. Because this law attempts to affect the terms of repayment by placing additional burdens on lenders before they may recover deficiency balances, NCUA determined that the law is preempted and does not apply to federal credit unions.

Ultimately, a determination on preemption will depend on the particular law involved and the extent of that law's attempt to regulate federal credit unions. There are numerous NCUA legal opinion letters on preemption. If a credit union should encounter a state law that could possibly be preempted by the FCU Act or NCUA's regulation, the credit union might want to consult with its local attorney to get an opinion on the details of the law and whether the law is in fact preempted.

Opening, Maintaining and Closing of Accounts

NCUA, in section 701.35 of its rules, preempts state laws affecting fees and other matters relating to the opening, maintaining and closing of share, share draft or share certificate accounts. State laws purporting to limit, prohibit or require fees or dividends would be preempted. NCUA has declared that the following are preempted by section 701.35:

- State laws that regulate dividends on escrow accounts. Whether an account will receive dividends and, if so, what the dividend rate will be are matters affecting the maintaining of a share account. *See*, NCUA Legal Opinion Letter 91-0503.
- State laws regulating to dormant account fees and conditions. Federal credit unions have exclusive authority to set their own dormant account policies and any fees relating to dormant accounts. Federal credit unions do, however, need to comply with state escheat laws. *See*, NCUA Legal Opinion Letters 06-1214 and 03-0855.
- State laws attempting to establish or regulate a specific type of account. For example, a state law which creates a specific consumer checking account and requires all financial institutions in the state to provide such an account does not apply to federal credit unions. *See*, NCUA Legal Opinion Letter 91-0747.
- State statutes that prohibit a financial institution from charging a fee for cashing a check drawn on that financial institution for non-accountholders. NCUA determined that federal credit unions may charge a fee to nonmembers for cashing "on-us" checks. *See,* NCUA Legal Opinion Letter 07-0743.

RESEARCH TIP: NCUA has issued several other legal opinion letters addressing specific state laws regarding accounts, including Legal Opinion Letters 98-0329 regarding a Maryland ATM fee law; 98-0926 regarding a Wyoming ATM law; 04-0259 regarding a Connecticut unclaimed property law; and 97-0331 regarding a Massachusetts law on electronic banking. Additional opinions can be found through NCUA's search function.

STATUTORY LIEN

The FCU Act provides federal credit unions with the power "to impress and enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him." NCUA codified this power in section 701.39 and allows federal credit unions to apply the statutory lien to any financial obligation owed by a member to the federal credit union.

MORE INFORMATION: A "statutory lien" is a legal term of art that refers to a lien on property that is created by the law, rather than by contractual agreement. The statutory lien provided for in the FCU Act is only one type of statutory lien.

Impressing the Lien

Impressing the lien is how the credit union makes the lien enforceable against the account. Under section 701.39(c), a federal credit union may impress a lien in one of three ways:

- Notice may be given to a member by way of the account opening documentation;
- For loans, by giving notice of the lien through the loan documentation that is signed or otherwise acknowledged by the member; or
- Through a bylaw amendment or policy, of which the member is given notice.

Credit unions are nearly uniform in their practice of impressing the lien by giving notice through account opening and loan documentation.

Notice

The notice must be written. It must disclose, in plain language, that the credit union has the right to impress and enforce a statutory lien against the member's shares and dividends in the event of failure to satisfy a financial obligation and that the credit union may enforce this right without further notice to the member.

Member

Section 701.39(a) defines the term "member" to mean any member who is primarily, secondarily or otherwise responsible for an outstanding financial obligation to the credit union. This could include an obligor, maker, co-maker, guarantor, co-signer, endorser, surety or accommodation party.

Enforcing the Lien

Once a lien is impressed, no further notice needs to be given to the member before it is enforced. The lien can be enforced only when a member is in default on an outstanding financial obligation. A federal credit union enforces the lien by debiting funds in the account and applying the funds to any "outstanding financial obligation due and payable to the credit union." *See*, 12 CFR § 701.39(d).

Freezing Accounts

Section 701.39 does not provide federal credit unions with the authority to freeze funds a member's account when the member becomes delinquent on a financial obligation. In a 2002 legal opinion letter, NCUA noted that section 701.39 permits a federal credit union to debit a member's account "to the extent of any of the member's outstanding financial obligations" with the federal credit union. However, the rule does not give a federal credit union the authority to freeze a member's account and create a share-secured loan. Federal credit unions must actually take the funds from the account to enforce the lien.

MORE INFORMATION: This does not mean it is illegal to freeze an account when a member is delinquent. Credit unions are not prohibited from contracting for the right to freeze an account by including appropriate provisions allowing them to do so in their account agreements.

Limitations on Enforcing the Lien

Federal credit unions should be aware that other federal or state law may supersede the statutory lien or give other liens a superior claim to the funds. Section 701.39 puts federal credit unions on notice of the possible existence of superseding federal or state law requirements by inserting the qualifying language "except as otherwise provided by law." The rule notes that it is the federal credit union's responsibility to determine whether such statutory or case law exists.

As an example of such a superseding law, Regulation Z prohibits a card issuer from offsetting any funds held on deposit with the issuer by the cardholder against an obligation owed on a credit card account. Thus, a federal credit union may not use its statutory lien power against a member's shares and dividends to satisfy a credit card debt. The member would need to give a consensual security interest in the account before the federal credit union could offset such funds to satisfy a credit card debt.

RESEARCH TIP: There are a few legal opinion letters on the application and use of the statutory lien. For example, NCUA Legal Opinion Letter 97-0423 discusses application of the lien in the context of negative share accounts.

EXPULSION

While we await NCUA's adoption of CUGMA's regulations, as of right now, expulsion of a member from a federal credit union is not an easy process. That makes sense: federal credit unions are member-oriented, member-owned, and member-operated. For that reason, federal credit unions must jump through some hoops before they can rid themselves of "troublesome" members.

NCUA has stated that the FCU Act provides all members with two basic rights – the right to vote at elections and the right to hold par value in a share account. These rights cannot be terminated except through the expulsion process.

The FCU Act permits expulsion in one of two ways, which are reiterated in Article XIV of the model bylaws. Federal credit unions may expel a member through a special meeting of the members or through a nonparticipation policy.

Expulsion does not relieve a member of any liability to the credit union. Thus, a member would remain liable for any outstanding loans owed to the credit union. However, the individual would no longer be a member and could not obtain additional loans, open new accounts or continue using existing accounts.

MORE INFORMATION: Neither NCUA nor the FCU Act has placed limitations on what can be the basis of an expulsion. However, NCUA has indicated that a credit union can run afoul of other laws by expelling a member in violation of those laws. For example, expelling a member due to their age or race may be a violation of state and federal laws.

Special Meeting

Under this method of expulsion, a special meeting must be called in accordance with the bylaws. Notice of the meeting must state the purpose of the meeting is to expel a member and no other business may be conducted at the meeting. The member up for expulsion must have the opportunity to be heard at the meeting. A two-thirds vote of the members present at the meeting is needed to expel a member. The requirements for expelling a member are spelled out in Article XIV of the model bylaws, and the procedures for holding a special meeting are spelled out in Article IV.

Nonparticipation Policy

The board may also adopt a nonparticipation policy. Nonparticipation is defined in the FCU Act as a member's failure to vote in elections or failure to purchase shares, obtain a loan or lend to the federal credit union. If a federal credit union adopts a nonparticipation policy, it must provide notice to the membership within 30 days of the effective date of the policy. Once adopted, the policy may be enforced to expel members that do not participate in the credit union.

NAFCU NOTE

This NAFCU *Compliance Monitor* article compiles and discusses the available legal opinion letters regarding expulsion and limitation of services (member-only).

Actions such as causing a loss to the credit union or verbally abusing staff members cannot be considered nonparticipation. To expel members for these and similar other actions, federal credit unions must make use of the special meeting and vote.

LIMITATION OF SERVICES

Federal credit unions do have options other than expulsion for members that cause a loss, are verbally abusive or demonstrate other behaviors that may be harmful to the federal credit union. Federal credit unions can establish a limitation of services or member in good standing policy. Article II of the model bylaws includes a statement that the board may adopt a limitation of services policy and includes a description of a member in good standing.

A limitation of services policy establishes certain behaviors exhibited by members that will lead to a limitation of certain services. The policy must be established by the board, in writing and communicated to the membership.

While the two basic rights to maintain a share account and vote in elections cannot be limited, federal credit unions may establish a policy that restricts other services to certain members. There must be a rational connection to the member's behavior and the services that are restricted and members must be given notice of the policy before it is enforced. Some examples are:

- Denying an abusive member access to services that involve contact with credit union staff, such as in-person transactions at teller or drive-thru windows;
- Denying loan services to members that have caused the credit union a loss; or
- Denying ATM card services to members that have abused their ATM privileges.

NCUA has noted that a mere suspicion of a member's activities would not constitute a rational basis for suspending a member's services. Additionally, NCUA makes a point of noting that contract provisions and state and federal law (such as the Equal Credit Opportunity Act) could affect a federal credit union's ability to institute a limitation of services policy.

NAFCU NOTE

In 2019, NCUA updated its bylaws. The NAFCU *Compliance Blog* covered the changes regarding expulsion and limitation of service. This blog also discusses the limitation of services policy.

CHAPTER 1 — FUNDAMENTALS

SECTION 7 — FIELD OF MEMBERSHIP FOR FEDERAL CREDIT UNIONS

FIELD OF MEMBERSHIP

In general, federal credit unions may only serve their members. Each federal credit union has its own distinct field of membership, which defines the persons and entities who may qualify as members. A federal credit union's distinct field of membership is specified in Section 5 of its charter.

TYPES OF CHARTERS

The FCU Act recognizes three types of federal credit union charters — single common bond, multiple common bond and community. Single common bond federal credit unions may have an occupational or associational common bond as its field of membership. A multiple common bond credit union serves multiple groups, each of which has its own occupational or associational common bond. A community credit union serves a field of membership defined by geographic boundaries. The requirements for each type of charter are outlined in NCUA's Chartering and Field of Membership Manual (FOM Manual).

MORE INFORMATION: The FOM Manual contains information for credit unions about how to amend their field of membership, which requires an application to and approval from NCUA. It also contains information about converting from one charter to another, mergers and spinning-off a portion of a field of membership into a new credit union. The requirements for these actions can vary between charter types.

Occupational Common Bond

An occupational common bond field of membership will include persons and entities that share the common occupational bond, usually a specific employer. NCUA permits occupational common bonds to be established in one of five ways:

- Employment in a single corporation or other legal entity. Employment may include a contractual relationship equivalent to employment;
- Employment in a corporation or other legal entity with a controlling ownership interest (not less than 10 percent) in or by another legal entity;
- Employment in a corporation or other legal entity which is related to another legal entity;
- Employment or attendance at a school; or
- Employment in the same trade, industry or profession.

EXAMPLE

Section 2.II.A.1 of the FOM Manual contains many examples of field of membership clauses illustrating a valid common bond for this type of charter. For example, "Employees of the Buffalo Manufacturing Company who work in the United States." or "Employees of and students attending Georgetown University."

The corporation itself may also be included in the common bond. If so, it will be mentioned in the last clause in Section 5 of the credit union's charter.

In the case of a trade, industry or profession (TIP), the occupational common bond is not based on a specific employer, but rather by virtue of producing similar products, similar services or participating in the same type of business. A TIP field of membership cannot be added to a multiple common bond federal credit union – it is only available to single common bond federal credit unions.

A TIP may also include in its membership employees of vendors, suppliers and contractors that have a "strong dependency relationship" and work directly with other types of entities within the industry. A "strong dependency relationship" exists when the absence of one entity is likely to cause the other entity's revenue, functionality or productivity to decline. Indicators of a strong relationship include regularly performing work at facilities directly related to the industry or the degree to which work practices adapt to the changing needs of the industry.

A federal credit union's occupational common bond does not have to include a geographic component, but one may be included (i.e., employees of LMN Corporation who work in Newark, NJ). A geographic limitation will often be required for a TIP.

EXAMPLE

Section 2.II.A.1 of the FOM Manual also contains an example of a field of membership clause that establishes a common bond under a TIP charter: "All licensed nurses in Fairfax County, Virginia."

Associational Common Bond

An associational common bond federal credit union may include in its field of membership all members and employees of an association. The simple fact that the association exists is not enough to show a common bond. First, an association must meet a threshold requirement in order to be added to a federal credit union's field of membership – the association cannot have been formed "primarily for the purpose of expanding" federal credit union membership. If the association does not meet the threshold test, NCUA will deny the addition of the association to the federal credit union's field of membership.

So what does NCUA mean by "primarily for the purpose of expanding membership?" While the FOM manual itself does not provide much context, the preamble to the rule provides some guidance on what "primarily" means:

> ***"…. The Board intends for the word "primarily" to be given its plain English definition. For purposes of this rule "primarily" means: for the most part; essentially; mostly; chiefly; principally."***

EXAMPLE

Section 2.III.A.3 of the FOM Manual contains examples of field of membership clauses illustrating a common bond, for example "Members of the University of Wisconsin Alumni Association, located in Green Bay, Wisconsin" or "Members of the Shalom Congregation in Chevy Chase, Maryland."

If an association meets the threshold requirement, NCUA will look at the "totality of the circumstances" to determine if the association's members truly share a common bond. A common bond will consist of individuals and/or groups whose members participate in activities developing common loyalties, mutual benefits and mutual interests. The totality of the circumstances test considers the following factors:

- Whether the association provides opportunities for members to participate in the furtherance of the goals of the association;
- Whether the association maintains a membership list;
- Whether the association sponsors other activities;

- Whether the association's membership eligibility requirements are authoritative;
- Whether members pay dues;
- Whether the members have voting rights. To meet this requirement, members need not vote directly for an officer, but may vote for a delegate who in turn represents the members' interests;
- The frequency of meetings; and
- Separateness. Corporate separateness exists when the credit union and the association do not have intermingled business transactions, accounts and corporate records. Associations already part of the credit union's field of membership that do not meet the corporate separateness factor will be grandfathered in if subject to a quality review.

When applying the test, NCUA places primary emphasis on the first four factors. However, the agency considers all of the criteria together to determine if an association has a common bond. No one factor alone is determinative.

A federal credit union's associational common bond does not have to include a geographic limitation, but a federal credit union may choose to limit its field of membership to a certain geographic location.

Multiple Common Bond

Multiple common bond federal credit unions serve numerous separate single associational and occupational common bond groups. Each group must have its own common bond and each group must be within the service area of the credit union. However, the separate groups do not need to have a consistent or similar common bond. Separate occupational common bond groups are often referred to as "select employee groups" (or SEGs). While a multiple common bond credit union can serve multiple SEGs, it may not serve a TIP group.

Certain SEG contractors may also qualify for membership. For example, individuals who regularly work for an entity that is under contract to the sponsor of the SEG listed in the federal credit union's charter can also become members of the credit union as long as there is a "strong dependency relationship" between the sponsor and the SEG. A "strong dependency relationship" requires the sponsor and SEG rely on each other as measured by a pattern of doing business regularly and documented by the number, term length and dollar volume of contracts between them.

A multiple common bond charter may also combine individual occupational groups that each consist of employees of a retailer or other business tenant of an industrial park, a shopping mall, office park or office building (each "a park"). The park must be within the credit union's service area and each tenant must have fewer than 3,000 employees working at a facility within the park. To qualify for membership, the employee must work regularly at the park and join the credit union while the retail or business is a park tenant.

To add a group to its charter, each group must have its own common bond and be within the service area of the federal credit union. A federal credit union’s service area is the geographic area that can reasonably be served by its service facilities. A service facility is defined as a place where shares are accepted for members’ accounts, loan applications are accepted or loans are disbursed. This definition includes:

- A federal credit union owned branch,
- A mobile branch,
- An office operated on a regularly scheduled weekly basis,
- A federal credit union owned ATM,
- A federal credit union owned electronic facility that meets the service facility definition, or
- A shared branch or shared branch network location including a shared electronic facility or ATM that meets the service facility definition.

Effective December 27, 2021, NCUA updated the definition of service facility to include shared branches or shared branch network locations regardless of whether the federal credit union has an ownership interest in the service facility, or the service facility is local to the federal credit union and the federal credit union is an authorized participant in the service center.

MORE INFORMATION: The preamble to the 2016 field of membership rule explains a federal credit union's Internet Web site is not a service facility. The preamble to the November 2021 field of membership rule confirms that a credit union’s internet website is not a service facility. NCUA Legal Opinion Letter 11-0965 states video-teller machines can qualify as service facilities in certain situations.

NCUA also requires a federal credit union to determine the stand-alone feasibility of groups that seek to be added to the field of membership of an existing multiple common bond credit union. Generally, this requires the federal credit union to demonstrate, with documentation, that the group does not have the ability to form its own credit union. The fewer members in the group, the less requirements and documentation are required. Groups of fewer than 3,000 members do not need to demonstrate an inability to form their own credit union.

EXAMPLE

Section 2.V.A.7 of the FOM Manual contains illustrations of community field of membership clauses, for example "Persons who live or work in Green County, Maine" or "Persons who live, work, or worship in the Binghamton, New York, Core Based Statistical Area, consisting of Broome and Tioga Counties, New York."

Underserved Areas

Multiple common bond credit unions may also add underserved areas to their fields of membership. An "underserved area" is one that:

1. Is a well-defined local community (as defined by the rules for community charters);
2. Meets the definition of an "investment area" under 12 USC § 4702(16); and
3. Is "underserved by other depository institutions" based on data of the NCUA Board and the federal banking agencies.

Underserved areas can be added without regard to location and the same area can be served by more than one federal credit union. A federal credit union has two years from the date the underserved area is added to its charter to establish an office or service facility in the community. For underserved areas, a service facility does not include ATMs or shared ATMs.

Community

Under a community charter, a federal credit union may serve persons, businesses and other legal entities in a certain geographic area. A federal credit union may choose to serve one or all of the following types of affinity groups within the defined community: persons who live in, worship in, attend school in or work in the community. Additionally, federal credit unions may also serve businesses and other legal entities located in the defined community.

To receive NCUA approval, a community's proposed geographic area must have clearly defined boundaries and must be either: (1) a well-defined local community or (2) a rural district. "Well-defined" means the proposed area has specific geographic boundaries, such as a city, township, county, school districts or a clearly identifiable neighborhood.

The well-defined local community requirement is met if one of the following applies:

- The area is a recognized Single Political Jurisdiction (SPJ), such as a city, county, or their political equivalent, or any portion thereof.
- The area is all or part of a Combined Statistical Area (CSA) or Core Based Statistical Area (CBSA), as determined by the U.S. Census Bureau, including a Metropolitan Statistical Area. The CSA or CBSA, or portion thereof, must be contiguous and have a population of 2.5 million or less people. Individual portions of a CBA or CBSA do not have to conform to internal boundaries, such as metropolitan division boundaries.
- The area is contiguous and there is compelling evidence of common interests or interaction such that the area is a local community. Federal credit unions must submit a narrative demonstrating the area is a local community. Federal credit unions may use the factors listed in Appendix 6 to the FOM Manual when drafting its narrative.

NAFCU NOTE

For more on drafting a narrative that demonstrates common interests or interaction, check out this NAFCU *Compliance Blog* post.

The FCU Act requires NCUA to define what constitutes a "rural district." NCUA has defined a rural district as an area of any geographical size that meets these criteria:

- The proposed district has well-defined, contiguous geographic boundaries;
- The total population of the proposed district does not exceed 1,000,000;
- The population meets one of the following:
  - either more than 50% of the proposed district's population resides in census blocks or other geographic units that are designated as rural by either the CFPB or the U.S. Census Bureau, or
  - the district has a population density of 100 persons or fewer per square mile; and
- The boundaries of the well-defined rural district do not exceed the outer boundaries of the states that are immediately contiguous to the state in which the credit union maintains its headquarters.

MORE INFORMATION: In 2016, NCUA amended the FOM Manual to give credit unions more flexibility in meeting the "well-defined local community" requirements. These amendments were the subject of litigation, prompting NCUA to issue additional amendments in 2018. The litigation has since been resolved and NCUA issued a rule in 2020 to address the results of the litigation.

Low-income Credit Unions

While not a field of membership type, credit unions that serve predominantly low-income individuals can obtain a low-income designation from NCUA. Credit unions with the low-income designation are given greater operational flexibility in certain areas such as the following:

- Accepting insured nonmember deposits;
- Exemption from the aggregate loan limit for member business loans; and
- Offering secondary capital accounts.

Low-income credit unions may also participate in special funding programs such as the Community Development Revolving Loan Program for Credit Unions.

To receive the designation, a credit union must serve predominantly low-income individuals. "Low-income" individuals are defined as those members:

- Who make less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics; or
- Whose annual household income falls at or below 80 percent of the median household income for the nation as established by the Census Bureau.

RESEARCH TIP: NCUA has issued a number of resources on the low-income designation: Low-Income Designation webpage, Low-Income Designation Fact Sheet and guidance on Maximizing the Low-Income Designation.

Other Persons Eligible for Membership

A federal credit union may choose to include in its field of membership other groups that, while not in the primary field of membership, have close ties to those in the primary field of membership. A federal credit union may choose to include the following:

- Employees of the federal credit union;
- Retired federal credit union employees;
- Volunteers, such as volunteers that work at a sponsor group;
- Spouses of persons who died while within the field of membership;
- Businesses and other legal entities in the charter, such as the sponsor corporation;
- Honorably discharged veterans of the U.S. Armed Forces,

- Members of the immediate family or household; or
- Organizations of such persons.

If a federal credit union wants to include these persons in its field of membership, they must be listed in its charter.

For members of the immediate family or household, it is not necessary that the primary member joins before his or her immediate family or household members may join. Immediate family is defined to include a spouse, child, sibling, parent, grandparent or grandchild (this includes stepparents, stepchildren, stepsiblings and adoptive relationships). Household is defined as persons living in the same residence maintaining a single economic unit.

NAFCU NOTE

This NAFCU *Compliance Blog* post provides more details on when immediate family is eligible for membership, including a helpful flowchart.

The phrase "organizations of such persons" means a group comprised solely of persons within the field of membership. If a credit union's charter includes this phrase, these organizations may join the credit union.

COMMON BOND ADVERTISING REQUIREMENTS

In a past legal opinion letter, NCUA explained federal credit unions must avoid "overly expansive" advertising that indicates membership in a federal credit union is "open to anyone." Such language can violate the accuracy requirements under section 740.2 because implying that membership is open to everybody indicates that common bond requirements do not apply. NCUA considers such advertising inaccurate or deceptive. Violating these rules can lead to penalties ranging from a Cease and Desist Order to divesting an associational group from the field of membership so federal credit unions should review advertising accordingly.

SERVICE TO BUSINESSES AND ORGANIZATIONS

Federal credit unions may offer services to businesses and organizations. Businesses may obtain share accounts as well as loans. Business loans are covered by NCUA's Member Business Loans/Commercial Lending regulation (12 CFR Part 723), which is discussed in Chapter 3, Section 1. This section will discuss general issues to consider for serving businesses and other organizations.

Field of Membership

As with individuals, a business or organization must be within a federal credit union's field of membership. A business or organization may be within the field of membership in three ways:

1. It is located within the credit union's geographic boundaries (only for community-chartered federal credit unions);
2. It is specifically listed in the credit union's charter; or
3. The charter language includes the phrase "organizations of such persons" and the business or organization is composed exclusively of persons within the field of membership.

RESEARCH TIP: NCUA's **Legal Opinion Letter 98-0618 is especially helpful in understanding the membership eligibility requirements for businesses and organizations.**

With respect to the third method, a corporation could qualify for membership if all the stockholders or owners were within the field of membership. A partnership could qualify if all the partners were within the field of membership. For a social group, such as a bowling league, all members of the club would need to be within the field of membership. Note that the requirement is to be "within the field of membership" rather than a requirement for these individuals to already be members.

Documentation

As part of its Customer Identification Program (CIP), as well as sound business practice, credit unions should obtain certain documentation from the business, which indicates that the business is a valid, legal entity. This will generally include a Taxpayer Identification Number (TIN), registration papers and a corporate resolution. Usually, a business will have an Employer Identification Number (EIN) for its TIN (sole proprietorships will usually operate under the owner's individual SSN). Registration papers, such as a corporation's articles of incorporation or a partnership's statement of partnership authority will demonstrate that the entity has been properly established under state law. A corporate resolution will indicate that the business entity is authorized to do business with the credit union. This corporate resolution should note which individuals are authorized to conduct transactions on behalf of the business and the credit union should have these individuals' signatures on file. Information about the business's beneficial owners may also need to be obtained.

MORE INFORMATION: For more information on CIP, credit unions can review Chapter 4, Section 1 or the CIP section of the FFIEC BSA/AML Examination Manual.

Member Agreements and Disclosures

Many of the consumer protection laws do not apply to business accounts. For example, Truth in Savings, Privacy and Regulation E govern consumer accounts only. However, certain regulations, such as Regulation D and Regulation CC, do, at least in part, apply to business accounts. For this reason, credit unions should take great care in drafting their business account member agreements. These agreements will serve as the contract between the business member and the credit union. A credit union could provide a business member the same account agreement it provides to its individual members; however, it should be aware that it could be contracting to apply strict consumer protections to its business accounts.

MORE INFORMATION: Federal credit unions may pay dividends on all member accounts, including all types of business accounts. Take a look at NCUA Legal Opinion Letter 97-0705 for more.

Share Insurance

A corporation, partnership or unincorporated association engaged in any independent activity will receive up to $250,000 of share insurance on its accounts. A business will satisfy the "independent activity" requirement as long as the business was not formed solely for the purpose of increasing NCUA insurance coverage. If the business is not formed as a corporation, partnership or unincorporated association, or if the business is not engaged in any independent activity, the account will be added with any other accounts owned by the person(s) owning the business and insured up to $250,000 in the aggregate.

SERVICE TO NONMEMBERS

Federal credit unions exist to serve their members and generally may not serve nonmembers. However, there are certain limited circumstances when federal credit unions may provide services to nonmembers.

Loans

Federal credit unions are authorized to grant loans only to members. NCUA has consistently indicated that federal credit unions may serve nonmembers in the lending context "as long as their involvement does not distort the relationship between the federal credit union and the member." However, this exception is very limited and does not allow a nonmember to be a co-applicant or co-borrower on a loan.

NCUA has indicated certain ways nonmembers may participate in the loan. Nonmembers, for example, can be cosigners or guarantors on member loans. In addition, a credit union member can extend the use of his or her credit card to a nonmember agent (i.e., authorized user) who may make charges using the member's card.

RESEARCH TIP: NCUA has issued many legal opinion letters regarding nonmember participation in loans, most notably Legal Opinion Letters 95-0616 and 00-0605.

Under section 701.21(g)(7), a nonmember may also assume a member's mortgage in conjunction with the nonmember's purchase of the member's principal residence. The terms of the loan must remain unchanged, including the maturity date, and the nonmember may assume only the remaining unpaid balance of the mortgage.

Joint Owners and Nonmember Deposits

Federal credit unions may accept deposits from nonmembers in limited circumstances. Members may have nonmembers as joint owners on their member accounts. The FCU Act provides:

> *"Shares may be issued in joint tenancy with right of survivorship with any persons designated by the credit union member, but no joint tenant shall be permitted to vote, obtain loans, or hold office, unless he is within the field of membership and is a qualified member."*

Thus, nonmembers may be a joint owner on an account with a member, but they may not vote or receive other member benefits. Conversely, the individual can open their own membership with the credit union if they are within the credit union's field of membership.

The FCU Act and section 701.32 of NCUA's regulations permit federal credit unions to accept nonmember deposits when those nonmembers are public units (such as a state or county), political subdivisions thereof (such as school districts or port authorities) and nonmember credit unions. Credit unions with a "low income credit union" designation may accept nonmember deposits with fewer restrictions.

There are limits, however. For example, the rule specifies the amount of nonmember shares may not exceed 50 percent of the credit union's net amount of paid-in and unimpaired capital and surplus less any public unit and nonmember shares or $3 million, whichever is greater. The credit union's nonmember share may exceed 70 percent of paid-in and unimpaired capital and surplus, only if the board adopts a specific written plan concerning the intended use of these funds that is consistent with prudent risk management principles.

Check Cashing and Funds Transfers

In general, federal credit unions are not permitted to cash checks for nonmembers. However, Congress amended the FCU Act in 2006 to permit federal credit unions to cash checks and offer funds transfers services to nonmembers who are within the credit union's field of membership. NCUA implemented this law in its regulations and allows federal credit unions to sell negotiable instruments; cash checks and money orders; and send and receive electronic funds transfers for nonmembers within its field of membership. Credit unions may charge a fee for providing these services. *See,* 12 CFR § 701.30.

Incidental Powers

NCUA allows federal credit unions to serve nonmembers when doing so is necessary to provide an expressly authorized service to members. Federal credit unions may also use their marketing power to serve nonmembers in a limited fashion. Marketing activities are a preapproved incidental power when designed to attract or retain members and encourage use of products and services. Marketing programs cannot become a substitute for membership; however, some programs could be designed to provide services to nonmembers for a limited period to attract membership.

NAFCU NOTE

This NAFCU *Compliance Monitor* article provides more details on providing services to nonmembers. It also includes a reference chart to NCUA's legal opinion letters on nonmember services (member-only).

CHAPTER 2

Member Accounts

Section 1: Regulation E

Section 2: Share Insurance

Section 3: Regulation CC

Section 4: Truth in Savings

Section 5: E-SIGN Act

CHAPTER 2 — MEMBER ACCOUNTS

SECTION 1 — REGULATION E

OVERVIEW

Regulation E (12 CFR Part 1005) implements the Electronic Funds Transfer Act (EFTA). It covers the disclosure requirements, liability limits and other member protections related to electronic fund transfers, prepaid accounts and remittance transfers. These requirements will be reviewed throughout this section.

SCOPE

It is important to understand the coverage of Regulation E because the requirements and protections do not extend to all types of accounts or all types of electronic transfers. In general, Regulation E applies to electronic fund transfers that are debited or credited to a member's account.

Covered Accounts

Section 1005.2(b)(1) defines "account" to include member asset accounts such as savings, checking and payroll cards held directly or indirectly by the credit union and established primarily for personal, family or household purposes. This definition does not extend to business purpose accounts, accounts held under a trust agreement or escrow accounts.

Notably, many accounts covered by Regulation E – such as savings or checking accounts – are also subject to the requirements of the NCUA's Truth in Savings Act regulations. Thus, compliance questions involving these accounts often require a compliance professional to review the requirements under *both* Regulation E and the Truth in Savings Act regulations. This chapter will focus solely on the Regulation E requirements, while the Truth in Savings Act requirements are discussed in Chapter 2, Section 4.

Covered Transfers

An "electronic fund transfer" (EFT) is defined in section 1005.3(b) as "any transfer of funds that is initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit a consumer's account." Section 1005.3(b)(1) and its staff commentary give examples of transfers included in this definition:

- Point-of-sale (POS) transfers – including both PIN-based and signature-based;
- ACH transfers;

- ATM transfers;
- Direct deposit or withdrawal of funds;
- Transfers initiated by telephone;
- Transfers initiated by a debit card – regardless of whether conducted through an electronic terminal;
- Electronic transfers using information from a check, such as a check processed via ACH; and
- Online bill payments.

The regulation also gives examples of transfers that are not electronic fund transfers: paper checks processed via check channels, wire transfers and certain automatic transfers occurring within the same credit union.

Whether or not a transfer is considered an electronic fund transfer will depend on the facts and circumstances of each case and credit unions should review the definition and commentary when making determinations rather than relying solely on a preprinted list of transfers. Remember, the regulations are not updated as often as new types of transfers are created and adopted by financial institutions. For example, text message transfers are not listed in Regulation E, but still could be covered under the regulation depending on how the transfer is processed.

RESEARCH TIP: The CFPB's examination manual on the EFTA can be a useful tool in researching Regulation E issues as it provides some additional details about the regulation's coverage and requirements.

ACCOUNT OPENING DISCLOSURES

Section 1005.7 requires credit unions to provide certain information about the account at the time the account is opened. This information includes:

- **Liability information.** A summary of the member's liability for unauthorized EFTs and the telephone number and address to notify the credit union of unauthorized EFTs;
- **Error resolution information.** A notice describing the credit union's error resolution responsibilities;
- **Business days.** The credit union's business days;
- **EFT limitations.** Types of EFTs the member may make and any limitations on the frequency or dollar amount;

- **Fees.** Fees imposed for EFTs;
- **Documents.** A summary of the member's right to receipts, periodic statements and preauthorized transfer notices; and
- **Stop payment.** A summary of the member's right to and procedures for stopping payment of a preauthorized EFT.

These disclosures must be provided at the time the EFT service is established or before the first EFT is made. The account opening disclosures can be included with other disclosures, such as Truth in Savings disclosures, and can be provided electronically subject to the E-SIGN Act's requirements.

SUBSEQUENT DISCLOSURES

In addition to the disclosures required when an account is opened, Regulation E also requires disclosures throughout the account relationship.

Periodic Statement Disclosures

Section 1005.9(b) requires a periodic statement for accounts to or from which an EFT can be made. The following information must be included on each periodic statement:

- EFT information such as the amount, date and payee;
- Account number;
- Fees imposed;
- Account balances at the start and end of the statement period;
- Telephone number and address to report unauthorized EFTs; and
- Telephone number to confirm preauthorized transfers.

The timing for when a periodic statement must be sent depends on whether or not an EFT has been conducted in the preceding months. If no EFTs have occurred, the credit union is only required to send periodic statements on a quarterly basis. However, if an EFT has occurred in the prior month, the rule requires the credit union to send a statement for that month. The staff commentary indicates if the credit union usually sends statements quarterly it must send interim statements corresponding to the month where an electronic funds transfer has occurred.

EXAMPLE

If a credit union usually sends quarterly periodic statements at the end of March, June, September and December, and the member conducts EFTs in February and October, the credit union would need to send a periodic statement for those months in addition to its regular quarterly statements.

Error Resolution Notice

As part of its disclosure requirements, Regulation E requires credit unions to send both an initial and annual error resolution notice informing members how to report errors or ask questions regarding EFTs. Under section 1005.7(b), the initial notice must be provided with the account opening disclosures. Under section 1005.8(b), the annual notice can be sent once a year or, alternatively, can be included as an abbreviated notice on each periodic statement. Appendix A to Regulation E includes model forms for both initial and annual notices (Model Form A-3).

Change-in-Terms Notices

Section 1005.8(a) requires notice to members when certain terms of the account are changed. The notice must be given at least 21 days prior to the effective date of the change. There is no specific wording or format required for the change-in-terms notice nor is there a model form. The notice can be included on or with a periodic statement or sent as a separate mailing.

A change-in-terms notice must be sent if the credit union: increases fees; increases potential liability for members; removes types of funds transfer options under the account; or increases the limitations on the frequency or dollar amount of transfers. A notice is not required if the credit union closes ATMs or cancels a member’s debit card.

UNAUTHORIZED TRANSFERS

Regulation E requires credit unions to investigate claims related to unauthorized EFTs and limits the amount of liability credit unions can pass on to members for these transfers. To understand when these rules apply it is important to start with the definition of an unauthorized EFT. Section 1005.2(m) explains an unauthorized EFT is any EFT from an account "initiated by a person other than the consumer without actual authority to initiate the transfer and from which the consumer receives no benefit."

NAFCU NOTE

This NAFCU *Compliance Blog* post provides more details on what types of transfers are considered unauthorized EFTs.

An unauthorized EFT includes situations where a member's account is accessed as a result of a robbery or fraud, such as phishing or card skimming. Similarly, if a member is forced to conduct a transfer (i.e., forced to input their card and PIN at an ATM under threat of violence), the transfers are unauthorized even though the member was the one who conducted the transfer.

The rule and staff commentary also provide a two examples of EFTs that are not considered unauthorized EFTs. First, an unauthorized EFT does not include a situation where the member acts, alone or with another person, with fraudulent intent. For example, if a member gives his brother his ATM card and PIN with the understanding the brother will withdraw money and the member will claim an unauthorized transfer, this would not be an unauthorized transfer because the member acted with fraudulent intent.

Second, if the member provides another person with authorization to make transfers from the account and they exceed the authority given by the member, those transfers are not unauthorized EFTs. However, once the member informs the credit union that this person no longer has authority to make transfers, then all future transfers are unauthorized EFTs. For example, if a member gives her daughter her debit card and PIN to purchase new shoes and the daughter instead buys a whole new wardrobe, the clothing purchases are not unauthorized. If the member informs the credit union her daughter no longer has authority to use her debit card and then the daughter uses the card to purchase a new computer, the computer purchase is an unauthorized EFTs as the member has revoked the authority.

MORE INFORMATION: In 2021, the CFPB issued FAQs on Regulation E that, in part, address unauthorized EFTs and error resolution. Some discuss fraud issues while others tackle specifics relative to person-to-person (P2P) payment applications. These are worth reviewing for clarification.

Error Resolution Procedures

When a member notifies a credit union of an unauthorized transfer, or other "error," section 1005.11 requires the credit union to investigate and resolve the claim within a specified time period. The notice from the member must be received within 60 days after the periodic statement showing the error was sent. The notice needs to contain sufficient information to identify the member's name and account number and provide known information about the type, date and amount of the alleged error.

NAFCU NOTE

For more on the error resolution procedures, check out this NAFCU *Compliance Monitor* article (member only).

A member's notice can be provided orally or in writing. If the credit union chooses, it can require members to follow up an oral notice with a written notice within 10 business days. If the credit union chooses this additional requirement, it must inform the member of the requirement to send a written notice at the time it received oral notice and provide the member with the proper address to use when sending the written notice. Importantly, the credit union cannot wait to begin its investigation until the written notice has been received. The investigation requirements discussed below begin when the member provides notice to the credit union – orally or in writing.

Investigation Requirements

Once a credit union has received a member's notice of error, under section 1005.11(c), the credit union has 10 business days to complete the investigation. If a credit union is unable to complete its investigation within 10 business days, the rule permits the credit union to take up to 45 days to conduct its investigation provided it does the following:

- Provisionally credits the member's account with the amount of the alleged error within 10 business days from the date of the notice. If the credit union requires, but does not receive, written confirmation within 10 business days of an oral notice of error, provisional credit need not be provided;
- Notifies the member, within two business days, of the provisional credit in their account;
- Provides the member with full use of the provisionally credited funds during the investigation;
- Corrects any errors within one business day from determining the error occurred as described; and
- Notifies the member of the investigation results within three business days.

The 10 business days (for the initial investigation and providing provisional credit) is extended to 20 business days if the alleged error occurred within 30 calendar days of when the first deposit was made to the account. For the longer 45 day investigation process, the time period is extended to 90 days if the transfer was either: 1) not initiated in a state (i.e., foreign transfers); 2) a point-of-sale transfer using a debit card (including both PIN and signature as well as online and telephone transfers); or 3) occurred within 30 calendar days of when the first deposit was made to the account.

During the investigation, credit unions may ask the member for documentation or other information from the member. However, credit unions may not postpone the investigation nor deny a claim based solely on the member's failure to provide such documentation. For example, although the credit union can request a copy of a police report the member has filed, it cannot require the member to provide a police report before it will begin or complete its investigation of the error. Similarly, the credit union cannot deny the member's claim because a police report was not provided.

If an error has occurred, section 1005.11(c) requires the credit union to correct the error within one business day of determining the error occurred. This may include crediting the member's account or making permanent the provisional credit. The credit union is also required to provide notice to the member within three business days of the conclusion of the investigation. The notice may be provided orally or in writing.

RESEARCH TIP: For more on a credit union's error resolution responsibilities, as well as member liability, see this Federal Reserve *Consumer Compliance Outlook* article.

If the credit union's investigation determines no error occurred or a different error occurred (such as a different amount or only one of the alleged transfers was an error), section 1005.11(d) requires the credit union to give written notice to the member. The notice must include the credit union's findings and inform the member of their rights to request the documentation the credit union relied upon. If provisional credit was provided, the notice must also identify the date and amount the member's account will be debited.

Member Liability

Under section 1005.6, the amount of liability that can be passed on to the member for unauthorized EFTs depends on the timing of the member's notification to the credit union. Notification is deemed to be given whenever the relevant information is given to the credit union regardless of whether the information is properly relayed to the fraud department. Notification can be made orally or in writing. As there are different notice requirements under the liability rules, a credit union may not be required to follow the error resolution procedures, but the liability rules will still apply.

As liability is dependent on when the member provides notice, a credit union may not use other factors to increase a member's liability. For example, if a member's negligence contributes to unauthorized EFTs occurring on the account, the rules do not permit the credit union to use that fact to hold the member liable for more than what is allowed under Regulation E.

Loss or Theft of an Access Device

There are three separate liability levels that apply when an access device has been lost or stolen. "Access device" is defined in section 1005.2(a)(1) as "a card, code or other means of access to a consumer's account, or any combination thereof, that may be used by the consumer to initiate electronic funds transfers."

Section 1005.6(b)(1) explains the first level applies to unauthorized transfers occurring within two business days of when the member first learns of the loss or theft. Under this level, the member's liability cannot exceed $50. The staff commentary explains the two business day timeframe depends on when the member "learns of the loss" not when the actual loss occurs. If the member provides notice to the credit union within the two business days, the other liability levels do not apply.

If the member does not notify the credit union within two business days of learning of the loss or theft, the second liability level will apply. Under this level, the member's liability can reach up to $500 for the unauthorized transfers occurring after the two business days but still within 60 days after the periodic statement showing the unauthorized transfer was sent. Section 1005.6(b)(2) provides a two-part test for calculating the amount. The first part is the amount the member can be held liable for under the first liability level. The second part is the amount of the transfers that took place after the two business day period ended and before notification to the credit union, up to maximum of $500 for both parts.

EXAMPLE

The staff commentary provides a helpful example: The consumer's card is stolen on Monday and he learns of the theft that same day but does not report the theft until Friday. The $500 limit applies because he failed to notify the credit union by midnight Wednesday, the two business day deadline. If a $100 unauthorized transfer was made on Tuesday and a $600 unauthorized transfer on Thursday, the consumer would be liable for $50 of the $100 transfer (according to the first liability level) plus $450 of the $600 transfer (according to the second liability level), for a total of $500. But if $600 was taken on Tuesday and $100 on Thursday, the consumer would be liable for $50 of the $600 plus $100, for a total of $150.

Section 1005.6(b)(3) explains the third liability level applies to all transfers occurring more than 60 days after the periodic statement showing the unauthorized transfer was sent. If the member has failed to provided notice of the unauthorized transfers within the first 60 days after the periodic statement showing the unauthorized transfer was sent, then they can be held fully liable for the transfers occurring after the 60 days. This is in addition to the liability amount calculated under the first two levels.

No Access Device Used

If no access device was used as part of the unauthorized EFT, there are two levels of liability. In this case, liability is dependent on when the periodic statement showing the unauthorized transfer was sent to the member. The first level applies to all transfers occurring within the first 60 days after the periodic statement showing the unauthorized transfer was sent. Under this level, the member cannot be held liable for any amount. For the second level, section 1005.6(b)(3) indicates the member can be held fully liable for unauthorized transfers that occur more than 60 days after the periodic statement is sent and prior to notice to the credit union.

MORE INFORMATION: For more details on the intricacies of the member liability sections of Regulation E, see the staff commentary to section 1005.6, which contains additional information and examples.

PROHIBITION ON REQUIRING ELECTRONIC PAYMENT OF LOANS

Often lost in the other requirements of Regulation E is the prohibition on requiring a member to repay a loan via a preauthorized electronic fund transfer to receive credit in section 1005.10(e). This means the credit union cannot create a product that forces the member to set up automatic electronic payments to repay the loan. However, the credit union can offer lower rates or fees on loans that have automatic repayment.

OVERDRAFT RULES FOR ATM AND ONE-TIME DEBIT CARD TRANSACTIONS

Section 1005.17 prevents a credit union from charging a fee for an "overdraft service" unless the member has opted-in for coverage. An "overdraft service" is a service where a credit union assesses a fee for paying a transaction when the member "has insufficient or unavailable funds in the account." The rule excludes lines of credit, such as overdraft lines of credit covered by Regulation Z, and transfers between a member's accounts, such as a transfer from a savings account to a checking account. The overdraft fee prohibition only applies to ATM and one-time debit card transactions. It does not cover checks, ACH transfers, or recurring debit card transactions (such as a monthly gym membership).

The credit union can still pay a transaction overdrawing a member's account even if it does not have a member's opt-in; however, it is not allowed to charge the member a fee for paying the transaction. A common situation is when a member swipes his or her card at a gas station and the merchant sends through a $1 authorization that is approved. The member fills up his or her gas tank and when the transaction later posts to the member's account it takes the account negative. Without an opt-in from the member, the credit union may pay the transaction but is prohibited from charging a fee for doing so.

RESEARCH TIP: For a comprehensive review of the overdraft rules, see this Federal Reserve *Consumer Compliance Outlook* article, which also includes 24 Q&As. For a discussion of best practices, review the Interagency Guidance for Overdraft Programs.

Opt-In Process

For the credit union to be able to charge the member an overdraft fee for an ATM or one-time debit card transaction, the member must opt-in. Under section 1005.17(b)(1), the opt-in process consists of four parts:

- The credit union provides the member an opt-in notice in writing (or electronically if agreed), which describes the credit union's overdraft program and discloses the potential fees;
- The credit union provides the member with a reasonable opportunity to provide the opt-in;
- The member provides affirmative consent (i.e., opt-in); and
- The credit union provides a written confirmation (or electronic if agreed) of the member's consent, which must include information about the member's ability to revoke their consent in the future.

Section 1005.17(d) requires the opt-in notice to follow Model Form A-9. The notice must be segregated from other information. The credit union can require the member to decide at account opening whether they would like to opt-in for overdraft coverage; however, all four steps of the process must still be completed. Credit unions are not required to complete the opt-in process as part of opening a new account.

Duration of Opt-in and Right to Revoke

Under section 1005.17(f), a member's opt-in is effective until it is revoked by the member or the credit union ceases to offer the overdraft service. A member can opt-in to overdraft coverage for ATM and one-time debit card transactions at any time during the account relationship. The member's right to revoke this opt-in also extends throughout the account relationship. The credit union must provide the same methods for a member to revoke as it does to allow a member to provide the initial opt-in consent.

For joint accounts, section 1005.17(e) explains any account owner can provide the opt-in to obtain overdraft coverage for ATM and one-time debit card transactions. The flip side of that coin is that the credit union must treat a revocation by any account owner as a revocation of the opt-in consent on the account. Thus, one joint owner could opt-in but have the consent revoked the next week by the other joint owner.

Prohibition on Conditioning and Same Terms Requirement

Section 1005.17(b) includes two separate provisions that require a credit union to treat members who do not opt-in the same as members who do opt-in. In other words, the credit union cannot punish members who have not agreed to overdraft coverage.

First, section 1005.17(b)(2) states the credit union cannot condition other overdraft services (such as for checks or ACH transfers) on whether the member has opted-in to overdraft coverage for ATM or one-time debit card transactions. Thus, the credit union cannot treat its overdraft program as an all or nothing program. The member must be able to obtain overdraft protection for checks, ACH and other transfers without being also required to opt-in for overdraft of ATM and one-time debit card transactions. Similarly, the credit union cannot refuse to pay checks or ACH transfers which overdraw the account solely because the member has not opted-in to overdraft coverage for ATM and one-time debit card transactions.

EXAMPLE

The staff commentary includes a detailed example: "For example, if an institution's internal criteria would lead the institution to pay a check overdraft if the consumer had affirmatively consented to the institution's overdraft service for ATM and one-time debit card transactions, it must also apply the same criteria in a consistent manner in determining whether to pay the check overdraft if the consumer has not opted in."

Second, section 1005.17(b)(3) states the credit union must offer the same account terms, conditions and features to members who do not opt-in as the credit union offers to those that do opt-in (aside from the actual overdraft coverage). For example, members who do not opt-in must receive the same dividend rate, same fees and the same card capabilities (such as both PIN and signature debit options). In short, all members must be treated similarly, without regard to whether a member has opted-in or not.

PREPAID ACCOUNTS

Prepaid accounts have their own disclosure requirements and consumer protections under Regulation E. These types of accounts are considered covered accounts, so the requirements discussed above for "accounts" still apply, including providing account opening disclosures and periodic statements and resolving errors. The rules for prepaid accounts discussed in this section apply in addition to Regulation E's other requirements.

Section 1005.2(b)(3) explains a "prepaid account" includes the following:

- Employer-established payroll card accounts to which electronic transfers of salary or other employee compensation are made on a recurring basis;
- Government benefits accounts established by a government agency for distributing government benefits to a consumer electronically;
- Accounts marketed or labeled as "prepaid" and redeemable at multiple, unaffiliated merchants or usable at ATMs; or
- Accounts meeting the three following conditions:
  - Is either issued on a prepaid basis in a specified amount or is not issued on a prepaid basis but capable of being loaded with funds thereafter;
  - Primary function is to conduct transfers with multiple, unaffiliated merchants, at ATMs or for person-to-person (P2P) transfers; and
  - Is *not* a checking account, share draft account or negotiable order of withdrawal account.

The definition of a prepaid account is rather complex so the regulation and staff commentary provides additional explanations and examples that credit unions may find helpful. For example, the commentary explains what it means for a prepaid card to be marketed or labeled as "prepaid," issued on a prepaid basis and capable of being loaded with funds. There are also examples applying the primary function test.

Section 1005.2(b)(3) provides some examples of products that are not prepaid accounts. These include certain gift certificates and gift cards; loyalty, award or promotional gift cards; general use prepaid cards marketed and labeled as a gift card or gift certificate and health savings accounts. "Pass-through" accounts only capable of transferring but not holding funds are also not considered prepaid accounts. An example of a pass-through account would be a digital wallet that is only capable of storing a member's payment credentials for other accounts but is incapable of storing any funds.

RESEARCH TIP: Because of the intricacies with the definition of a prepaid account, the CFPB created a flowchart to help credit unions determine whether a particular product meets the definition of prepaid account.

Disclosures

Section 1005.18 requires various types of disclosures for prepaid accounts both when the account is acquired and throughout the account relationship. The two main disclosure requirements, pre-acquisition and periodic statement disclosures, are discussed below but other required disclosures include: account opening disclosures required under section 1005.7, change in terms notices, access device disclosures and notices regarding unregistered prepaid accounts.

Pre-Acquisition Disclosures

Before a member acquires a prepaid account, section 1005.18(b) requires two disclosures: 1) a short form disclosure and 2) a long form disclosure. In general, a member acquires a prepaid account by purchasing, opening or choosing to be paid or receive wages via a prepaid account. There are specific content, placement and font size requirements for the short and long form disclosures. To assist credit unions in meeting these requirements, there are several model form disclosures that offer a safe harbor to credit unions that use them.

There are additional requirements for the disclosures if a prepaid account is acquired electronically, such as online or via a mobile app. Staff commentary explains credit unions must ensure the member is required to view the webpage displaying the pre-acquisition disclosures before accepting the prepaid account. Section 1005.18(b)(6)(i)(B) requires the electronic disclosures be viewable across all screen sizes, in a responsive form and using machine-readable text. For accounts acquired electronically, the pre-acquisition disclosures may be provided electronically without obtaining the consumer's consent in accordance with the E-SIGN Act.

Periodic Statement Disclosures

The periodic statement disclosures outlined in section 1005.9(b) apply to all prepaid accounts. Rather than sending a periodic statement each month or quarter for prepaid accounts, section 1005.18(c)(1) permits credit unions to provide alternative disclosures. To meet the alternative disclosure requirement, the rule requires credit unions to provide all of the following:

- The account balance via phone;
- An electronic history of account transfers for at least the past 12 months; and
- Upon request, a written history of account transfers for at least the past 24 months.

The electronic and written histories must include all of the information required for periodic statements under section 1005.9(b) and must also disclose the amount of any fee assessed against the account, not just those fees associated with EFTs. A total of all fees assessed against the account must be included on each history for the previous calendar month and for the current calendar year to date.

MORE INFORMATION: **The CFPB's Prepaid Rule webpage contains a number of helpful resources, including a coverage chart, small entity compliance guide and examination procedures.**

Error Resolution Procedures and Liability

The error resolution procedures outlined in section 1005.11 and the liability limitations outlined in section 1005.6 apply to verified prepaid accounts. Section 1005.18(e)(3) provides additional information on when a prepaid account is considered unverified. Unverified accounts are fully exempt from the error resolution and liability rules.

For verified prepaid accounts, the rules require credit unions to investigate and resolve errors based on the same time periods stated in section 1005.11(c) when it receives timely notice of an error. Notice is timely when it is received within 60 days of when the credit union sent the periodic statement reflecting the error. Section 1005.18(e)(2) provides a modified notice time period for credit unions using the periodic statement alternative. Under the modified timeline, an error must be investigated if notice is received by the earlier of: 1) 60 days after the consumer accesses an electronic history that reflects the error, or 2) sixty days after the credit union sends a written history that reflects the error.

As an alternative to tracking the 60 days from accessing an electronic history or sending a written history, section 1005.18(e)(2)(ii) provides a safe harbor timeline. A credit union that investigates any error when notice is received within 120 days of the date the error was credited or debited to the account has properly complied with the rule.

If the error is an unauthorized EFT on a verified prepaid account, the liability limitations in section 1005.6 still apply. However, the deadlines set in section 1005.6 for determining liability also rely heavily on sending a periodic statement, and thus section 1005.18 modifies those deadlines for credit unions using the periodic statement alternative. Section 1005.18(e)(1) uses the same "earlier of" test described above for the investigation rules. The 120-day safe harbor also applies, which starts on the date the unauthorized EFT was debited to the account.

NAFCU NOTE

This NAFCU *Compliance Monitor* article provides more details on requirements for prepaid accounts (member-only).

REMITTANCE TRANSFERS

Remittance transfers are covered under Subpart B of Regulation E. They are not considered EFTs, so the rules discussed above, including disclosures and error resolution, do not apply to remittance transfers. Only the requirements outlined in Subpart B apply.

Determining what is (and what is not) a remittance transfer is the first and arguably the most important step in determining your credit union's compliance obligations under the remittance transfer regulations. Under section 1005.30, a remittance transfer is "the electronic transfer of funds requested by a sender to a designated recipient that is sent by a remittance transfer provider." A "sender" is the person requesting the remittance transfer be sent to the designated recipient for personal, family or household purposes. A "designated recipient" is the person receiving the remittance transfer. The designated recipient must be located in a foreign country and can be either an individual or a business.

A "remittance transfer provider" is the person who provides remittance transfers in the normal course of business. To assist credit unions in determining whether they are providing remittance transfers in the normal course of business, section 1005.30(f)(2) provides a safe harbor. A credit union is not providing transfers in the normal course of business if it provided 500 or fewer transfers in the previous calendar year and provides 500 or fewer transfers in the current calendar year. If a credit union provided fewer than 500 transfers in each year, then it is not a remittance transfer provider and it would not have to comply with the remittance transfer regulations. The staff commentary provides further clarifications and guidance on these definitions.

Disclosures

Section 1005.31 requires credit unions who are remittance transfer providers to provide two types of disclosures to members requesting remittance transfers: 1) a pre-payment disclosure when the sender requests the remittance transfer but before payment is made and 2) a receipt when the sender authorizes the payment. These two disclosures can be combined into a single disclosure as long as the credit union provides the member with proof of payment when the payment is made. Model disclosures can be found in Appendix A to Part 1005.

All disclosures must be provided in writing (or electronically if agreed) and in a retainable form unless the disclosures are provided via mobile app or text message to the extent permitted by section 1005.31(a)(5). Section 1005.31(e)(2) contains certain exceptions for transfers completed entirely by telephone, via mobile application or text message transfers. Credit unions conducting remittance transfers in this manner should closely review the regulation and staff commentary for additional information about the disclosure requirements.

Cancellation

Section 1005.34 contains the procedures for cancellation and refund of remittance transfers. A sender has the right to cancel a remittance transfer and receive a refund for up to 30 minutes after payment has been authorized for the remittance transfer, provided that:

- The request to cancel enables the provider to identify the sender's name and address or telephone number and the particular transfer to be cancelled; and
- The transferred funds have not been picked up by the designated recipient or deposited into an account of the designated recipient.

This provision does not *require* that the credit union wait 30 minutes prior to accepting payment, nor does it require the credit union to wait 30 minutes to send the funds to the designated recipient. However, for operational reasons and to ensure that a member could cancel the remittance transfer and receive their refund, the credit union might delay transmittal until the expiration of the cancellation period.

MORE INFORMATION: The CFPB's Remittance Transfer Rule webpage contains a number of helpful resources, including a small entity compliance guide, model forms and a list of the countries exempt from the rule.

Error Resolution Procedures

Section 1005.33 contains the procedures for resolving errors for remittance transfers. These procures apply to any "error" which includes an incorrect amount paid by a sender, a computational error made by the credit union or the failure to make funds available to a designated recipient by the date disclosed. An error does not include situations where the funds were sent to the wrong account because the sender provided the credit union with the wrong account number or institution identifier (such as a routing number).

Once a credit union has received notice of an error from the sender, section 1005.33(c) and (d) provide the specific procedures a credit union is required to follow. These include timely investigating and resolving the error. The specific resolution required will depend on the type of error asserted. Credit unions receiving a notice of error related to a remittance transfer should review the regulation and related staff commentary to ensure it is properly resolving any errors.

CHAPTER 2 — MEMBER ACCOUNTS

SECTION 2 — SHARE INSURANCE

OVERVIEW

NCUA insures member accounts through the National Credit Union Share Insurance Fund (NCUSIF). The NCUSIF was established in 1970 and is backed by the full faith and credit of the United States Government. The Federal Credit Union Act requires Federal Credit Unions to apply for and obtain insurance through the NCUSIF. State-chartered credit unions may apply for share insurance through the NCUSIF at any time. By law, federally insured credit unions must maintain one percent of the credit union's shares in the NCUSIF. NCUA's share insurance rules are found in Part 745.

The share insurance coverage on a member's account depends on the account ownership type. A member can increase their share insurance coverage by having more than one account ownership type, as NCUA insures these separately. For example, a member could have an individual account and a joint account. The member's insurance coverage for these accounts would be insured separately, as the accounts are different account ownership types.

A member's account can only be one account ownership type at a time. This is a key distinction to remember when working with share insurance. Think of it as different "insurance buckets." A member's account can only fit into one "bucket" at a time. For example, an account cannot be both an individual account and a "payable-on-death" account. As soon as the member names a beneficiary, the account is a revocable trust account and no longer an individual account. The account would then be insured as a revocable trust account and insured separately from any individual accounts the member holds at the credit union.

This section will provide an overview of share insurance account coverage, discuss credit union mergers or failures and also address the disclosure requirements for the official insurance sign and official advertising statement.

SMSIA

The Standard Maximum Share Insurance Amount (SMSIA) is the amount of share insurance available per qualifying account and is determined by Congress. For years, the SMSIA was set at $100,000. In 2008, Congress temporarily increased the SMSIA to $250,000. This increase was made permanent by Dodd-Frank. Currently, the SMSIA remains set at $250,000. It would take a legislative change to amend the SMSIA in the future.

SINGLE OWNERSHIP ACCOUNTS

A member's funds in single ownership accounts are added together and insured up to $250,000. This applies to accounts the member has in their individual name – such as savings, checking, money market and share certificates. Any joint accounts or revocable trust accounts the member owns are insured separately (as they would be in separate insurance "buckets").

Thus, if a member has $200,000 in a share certificate, $40,000 in savings and $20,000 in a checking account – all under his individual name – the member would have $10,000 in uninsured funds. This is because the member's individual accounts are added together for a total amount of$260,000 – and insured up to $250,000.

JOINT OWNERSHIP ACCOUNTS

NCUA insures joint accounts separately from non-joint accounts at the credit union. The separate coverage does not depend on how the joint account is set up. It could be set up as joint tenants with right of survivorship, as tenants by the entireties, as tenants in common or by husband and wife as community property. If a member has more than one joint account at the credit union, the member's interest in any joint accounts are added together and insured up to $250,000.

A key to joint accounts is that *each joint owner* receives up to $250,000. Thus, if a husband and wife open a joint account at the credit union, they will be insured up to $500,000. Note, a joint account may be opened by any two credit union members. There does not need to be a familial relationship. For example, two friends could open a joint account. This insurance is separate from any individual accounts at the credit union. In other words, the husband and wife could each have up to $250,000 in individual accounts without any impact on their insurance coverage for the joint account.

If there are three joint owners on an account – the account is insured up to $750,000 ($250,000 per owner). But, remember that if a member has multiple joint accounts at the credit union the member's joint accounts are added together and insured up to a total of $250,000.

RESEARCH TIP: NCUA has issued numerous legal opinion letters regarding the insurance of joint accounts, revocable trusts, and other types of member accounts.

Example of Multiple Joint Accounts

An example can help clarify this coverage. Assume Sue and Jim have a joint account (Account 1) at the credit union. Sue also has a joint account (Account 2) with Ray. Jim and Sue will each be insured up to $250,000 for their ownership in Account 1. Sue does not receive any additional coverage even though she has two joint accounts. Assume Account 1 has a balance of $400,000 and Account 2 also has a $400,000 balance. Jim and Ray would both be fully insured as their ownership interests are $200,000 and they can each receive up to $250,000 in insurance coverage for joint accounts. Sue has an ownership interest of $400,000 between the two joint accounts. However, she is only insured for up to $250,000 in all of her joint accounts. Thus, Sue will be insured for $250,000, leaving $150,000 uninsured.

This example is best illustrated by running it through [NCUA's Share Insurance Estimator.] The share insurance estimator allows credit unions (and members) to calculate share insurance coverage to help maximize coverage and prevent funds from being uninsured. The outcome is as shown:

Joint Accounts

	Account Nickname	Balance	Owner(s)	Beneficiaries
Edit Delete	Account 1	$400,000.00	Sue Jim	NA
Edit Delete	Account 2	$400,000.00	Sue Ray	NA

Insurance Summary	Balance	Insured	Uninsured
Sue Joint	$400,000.00	$250,000.00	$150,000.00
Jim Joint	$200,000.00	$200,000.00	$0.00
Ray Joint	$200,000.00	$200,000.00	$0.00

Total for all accounts at Sample FCU (Totals will be rounded)

Balance	Insured	Uninsured
$800,000.00	$650,000.00	$150,000.00

If you'd like to learn more about what you can do to protect your shares please contact your credit union or the NCUA at 1-800-775-1030.

This calculation assumes that all of the above accounts are on deposit in a federally insured credit union, and that the account owners do not have accounts other than those listed above at Sample FCU.

Qualifications for Joint Account Coverage

To qualify for joint account insurance coverage, the account must be a "qualifying joint account." To be a qualifying joint account, each of the co-owners must have personally signed a membership or account signature card and each of the co-owners must have a right of withdrawal on the same basis as the other co-owners. Note, the signature requirement does not apply to share certificates, or to any accounts maintained by an agent, nominee, guardian, custodian or conservator on behalf of two or more persons if the records of the credit union properly reflect that the account is so maintained.

If a joint account fails to qualify, the account will be insured as an individual account for each of the co-owners. The co-owners' interest in a non-qualifying account will be added to the members' other individual accounts for share insurance purposes.

Special Situation – Nonmember. In cases where a nonmember is a co-owner of a joint account with a right of survivorship, the nonmember's interest in the account will be insured the same as the member's interest in the account. In other words, only the SMSIA for the member ($250,000) will apply.

Special Situation – Owners as Beneficiaries. If members create a joint revocable trust account which names themselves as the sole beneficiaries, NCUA insures these accounts as joint accounts rather than revocable trust accounts. The account would not be insured as a revocable trust account because the member's fail the "intent" test in the revocable trust requirement. Since the member's named themselves as sole beneficiaries, their "intent" was not to pass the funds to the beneficiaries upon their death.

EXAMPLE

For example, if Joe and Sue opened an account titled "Joe and Sue payable-on-death to Joe and Sue" – NCUA would insure the account as a joint account rather than a joint revocable trust account.

REVOCABLE TRUST ACCOUNTS

NCUA insures revocable trusts separately from other types of accounts at the credit union. Revocable trusts can be either formal or informal. Informal trusts are commonly referred to as payable-on-death accounts, in-trust-for accounts or Totten Trust accounts. Formal revocable trusts include living trusts and family trusts. However, state law covers trust creation and each state may have specific requirements for what constitutes a trust account.

Section 745.4 contains the rules regarding insurance of revocable trust accounts. In order to be a revocable trust account, the member must intend the funds to be passed on to one or more beneficiaries upon his or her death. The evidence of this intent must be reflected in the account title or in the account records.

If evidence is included in the account title, the credit union needs to use terms such as *in trust for*, *as trustee for*, *payable-on-death to*, or similar language. If the evidence is included in the account records, the records should list the beneficiaries. For informal revocable trusts (i.e., a payable-on-death (POD) account), the account records must specifically name the listed beneficiaries.

NAFCU NOTE

This NAFCU Q&A discusses how to determine the share insurance amount for a revocable trust account. The amount of insurance is based on the number of beneficiaries to the trust (member-only).

General Coverage for Revocable Trusts

The share insurance coverage for funds in revocable trust accounts flows from the beneficiaries on the accounts, rather than the owner(s). A beneficiary can be a natural person or a non-profit entity (such as a charitable organization) recognized under the Internal Revenue Code.

The general rule for share insurance coverage of revocable trusts provides that the account will be insured for up to the total number of beneficiaries named multiplied by $250,000. Thus, an account with four named beneficiaries will be insured up to $1,000,000 (up to $250,000 per beneficiary). There is a special rule, discussed below, which applies if a revocable trust has more than five beneficiaries and more than $1,250,000 in the account.

Special Situation – Multiple Revocable Trusts. Naming a beneficiary on more than one revocable trust account may not increase a member's share insurance coverage. For example, assume a member has an account payable-on-death to Susan and Bill with a balance of $500,000. This account will be fully insured for the $500,000 because the member would receive $250,000 in insurance coverage for Susan and $250,000 for Bill. However, the member would not receive any additional coverage by opening a second account payable-on-death to Bill. The member only receives up to $250,000 total for Bill as a beneficiary. Note, the actual determination depends on the account balances of the accounts. The member only receives $250,000 total for naming Bill as a beneficiary. The $250,000, however, can be split among multiple revocable trust accounts.

Joint Revocable Trust Accounts

A confusing situation is when a revocable trust account is owned jointly. In these situations, the insurance coverage is addressed in [section 745.4(f)](#).

In a joint revocable trust account, both owners receive share insurance coverage for any named beneficiaries. Thus, if Ray and Ramona opened a joint revocable trust account naming their daughter Samantha as the sole beneficiary – the account would be insured up to $500,000. Ray and Ramona each receive $250,000 in insurance coverage which flows from the beneficiary (Samantha).

Revocable Trust Accounts

	Account Nickname	Balance	Owner(s)	Beneficiaries
Edit Delete	Joint Revocable Trust	$500,000.00	Ray Ramona	Samantha

Insurance Summary	Balance	Insured	Uninsured
Ray Living Trust Samantha	$250,000.00	$250,000.00	$0.00
Ramona Living Trust Samantha	$250,000.00	$250,000.00	$0.00

Total for all accounts at Sample FCU (Totals will be rounded)

Balance	Insured	Uninsured
$500,000.00	$500,000.00	$0.00

The basic formula for joint revocable accounts is: the number of owners multiplied by the number of beneficiaries – then multiplied by $250,000. In the example above, two owners multiplied by one beneficiary – multiplied by $250,000 provides a total of $500,000 in insurance coverage.

Thus, a joint revocable trust with two owners and three beneficiaries could receive $1,500,000 in insurance coverage (*remember:* each owner receives $250,000 in coverage for each beneficiary). The calculation would be two owners multiplied by three beneficiaries – multiplied by $250,000, totaling $1,500,000 in coverage.

These types of accounts are subject to the special rule discussed below.

Special Rule for Complex Revocable Trusts

A special rule applies to the share insurance coverage of complex revocable trust accounts. This rule applies if the account has more than five beneficiaries *and* an account balance of more than $1,250,000. This rule could also apply if a member has multiple revocable trust accounts at the credit union which meet the test when combined. Section 745.4(e) explains this special rule.

The special rule limits the share insurance coverage to the **greater of**:

- $1,250,000; or
- The aggregate amount of the interests of each different beneficiary named in the trusts, to a limit of $250,000 per beneficiary.

The rationale for this rule is to prevent the ability for members to add "nominal" beneficiaries to their accounts in efforts to increase their share insurance. Without this rule, a member would be able to add a beneficiary to an account with a $100 interest in the account and receive an additional $250,000 in share insurance coverage.

If the interest of the beneficiaries on the account is not specifically listed, the presumption is that each listed beneficiary receives an equal share. Thus, if there were three listed beneficiaries each would have a one-third interest.

NAFCU NOTE

This NAFCU Q&A discusses recordkeeping requirements that apply to trust accounts. For example, the account records should name both the settlor and the trustee.

Examples of the Special Rule

Examples are the best way to understand this special rule.

Example 1. Assume a member has a revocable trust account naming the member's three children, two charities and the member's neighbor as beneficiaries. The account has a balance of $2,000,000. Each beneficiary has an **equal interest** in the account (one-sixth). This account will be subject to the special rule as it names more than five beneficiaries **and** has an account balance of more than $1,250,000. The insurance coverage is determined using the "greater of" formula from above.

In this situation, the beneficiaries each have an equal interest in the account ($333,333.33) and the member would receive $250,000 in insurance coverage for each beneficiary. This is due to the limitation of $250,000 per beneficiary for complex revocable trust accounts. The account would be insured for $1,500,000 (six beneficiaries multiplied by $250,000) with $500,000 uninsured. Remember, the special rule uses the "greater of" language and the second part of the test results in $1,500,000 in insurance coverage.

Revocable Trust Accounts

	Account Nickname	Balance	Owner(s)	Beneficiaries
Edit Delete	Complex Revocable Trust	$2,000,000.00	Jim	Child 1 Child 2 Child 3 Charity 1 Charity 2 Neighbor

Insurance Summary	Balance	Insured	Uninsured
Jim Living Trust Child 1, Child 2, Child 3, Charity 1, Charity 2, Neighbor	$2,000,000.00	$1,500,000.00	$500,000.00

Total for all accounts at Sample FCU (Totals will be rounded)

Balance	Insured	Uninsured
$2,000,000.00	$1,500,000.00	$500,000.00

If you'd like to learn more about what you can do to protect your shares please contact your credit union or the NCUA at 1-800-775-1030.

This calculation assumes that all of the above accounts are on deposit in a federally insured credit union, and that the account owners do not have accounts other than those listed above at Sample FCU.

Example 2. Similar to Example 1, assume a member has a revocable trust account naming the member's three children, two charities and the member's neighbor as beneficiaries. The account has a balance of $2,000,000. However, each beneficiary's interest is specifically listed. The three children each have a 30 percent interest in the account, the two charities each have a 4 percent interest in the account and the member's neighbor has a 2 percent interest in the account. This account will also be subject to the special rule as the account names more than five beneficiaries and has an account balance of more than $1,250,000.

The share insurance calculation is a bit more complicated, however, because the interests of the beneficiaries are not equal. The "greater of" formula will still apply. The table below shows each beneficiaries "interest" in the account.

Beneficiary	Interest %	Interest Amount (% multiplied by balance)
Child 1	30%	$600,000
Child 2	30%	$600,000
Child 3	30%	$600,000
Charity 1	4%	$80,000
Charity 2	4%	$80,000
Neighbor	2%	$40,000

The second part of the "greater of" formula needs to be calculated to determine the member's share insurance coverage. Following the general insurance rules, the member is limited to $250,000 in insurance coverage for each child even though their interest is greater than $250,000. The member will also receive insurance coverage for the aggregate amount of the other beneficiaries' interest in the account ($80,000 for each charity and $40,000 for the neighbor). Thus, the second part of the test reveals the account would be insured up to $950,000.

In this situation, the account will be insured for $1,250,000, as that amount is "greater than" the amount determined by the formula, $950,000. This means the account has $750,000 in uninsured shares.

The key in these complex revocable trust accounts is to calculate the share insurance coverage using both tests. Then apply the "greater of" test to determine the insured amount. Also, NCUA's share insurance estimator does not work for complex revocable trust accounts where the beneficiaries' interests are not equal.

IRREVOCABLE TRUST ACCOUNTS

NCUA insures irrevocable trusts separately from other accounts at the credit union. In other words, irrevocable trusts have their own share insurance "bucket." They are separately insured from revocable trusts as well.

The interest of each beneficiary under an irrevocable trust account is insured up to $250,000. This coverage is separate from any other accounts held by the trustee, settlor or the beneficiary. However, if a beneficiary has an interest in multiple irrevocable trusts established by the same settlor – the beneficiary's interests will be insured up to a total of $250,000 combined. Either the settlor or beneficiary must be a member of the credit union to obtain share insurance coverage. Coverdell Education Savings Accounts are considered irrevocable trusts for share insurance purposes and are insured up to $250,000.

RETIREMENT ACCOUNTS

NCUA insures certain retirement accounts up to $250,000. Individual Retirement Accounts (IRAs), Roth IRAs and Keogh accounts are all insurable accounts and are insured separately from a member's other accounts at the credit union.

A member's IRA and Roth IRA accounts will be combined for share insurance coverage purposes. The member can be insured up to $250,000, combined, for these IRA accounts. For example, if a member has $150,000 in an IRA account and $150,000 in a Roth IRA account, the member would be insured for $250,000 in insurance coverage and would have $50,000 in uninsured shares.

Keogh accounts are insured separately from IRA and Roth IRA accounts. A member can receive up to $250,000 in insured shares in Keogh accounts. Again, the share insurance "buckets" is a useful reminder. IRAs and Roth IRAs are combined into one insurance "bucket" and Keogh accounts have their own "bucket."

MORE INFORMATION: **In Legal Opinion Letter 11-0241, NCUA explains that share insurance for inherited IRAs will continue to be covered up to $250,000 separately from other IRAs and accounts owned by the beneficiary.**

BUSINESS ACCOUNTS

NCUA provides up to $250,000 in insurance coverage for business accounts. Coverage applies to corporations, partnerships and unincorporated associations. These business accounts are insured up to $250,000 total as long as the business is engaged in an "independent activity." Under the rules, "independent activity" means an activity other than one directed solely at increasing insurance coverage. Where the activity does not meet this definition, the business account will be deemed to be owned by the person that owns the business, and funds in such account will be added to the person's individual account and be insured up to $250,000. To be excluded from the definition, the business would need to be established *solely* for share insurance purposes. Of course, this is very rare.

Special Situation – Sole Proprietors. Sole proprietorship accounts, including "doing business as" (DBA) accounts, are insured as individual accounts rather than business accounts. Any sole proprietorship accounts are combined with the member's other individual accounts at the credit union.

NAFCU NOTE

This NAFCU Q&A discusses how businesses qualify for separate share insurance (member-only).

EXECUTOR OR ADMINISTRATOR ACCOUNTS

NCUA's share insurance rules provide up to $250,000 in separate coverage for accounts held by executors or administrators. Insurance coverage applies regardless of whether the account is held in the name of the person who passed away ("decedent"), or in the name of the executor or administrator. The coverage is separate from the individual accounts of the beneficiaries as well as separate from individual accounts of the executor or administrator.

FUNDS HELD BY A GUARDIAN OR CUSTODIAN

Funds held for a ward or for a benefit of a guardian under the Uniform Gifts to Minors Act (UGMA) and deposited in the name of the guardian, custodian or conservator are insured up to $250,000. This insurance coverage is separate from any other accounts of the guardian, custodian, conservator, ward or minor.

For example, assume a member, who is a minor, has an individual account at the credit union with a balance of $1,000. The member's grandfather makes a gift to him of $250,000 which is put in an account at the credit union with the member's father named as custodian under UGMA. The custodian account is fully insured at $250,000. The members' individual account is insured separately. Any accounts of the grandfather and father are also separately insured and are not impacted by the custodial account.

SPECIAL SHARE INSURANCE ISSUES

IOLTAs and Other Similar Escrow Accounts

Share insurance can also apply to certain escrow accounts such as Interest on Lawyer Trust Accounts (IOLTAs) and other "similar escrow accounts." A "similar escrow account" is an account where "a licensed professional or other individual serving in a fiduciary capacity holds funds for the benefit of a client as part of a transaction or business relationship." NCUA specified real estate escrow accounts and prepaid funeral accounts as examples of accounts which are likely to qualify under the rule. Coverage for other accounts should be determined on a case-by-case basis, and credit unions may contact NCUA for help in making that determination.

MORE INFORMATION: For details on this rule, see NCUA's Regulatory Alert 16-RA-02 and its enclosure "Guidance on Enhanced Share Insurance." The regulatory alert specified, among other things, that prepaid cards, such as payroll cards, do not qualify for insurance as a "similar escrow account."

Other similar escrow accounts are insured on a "pass-through" basis for each client or principal whose funds are being held and administered by the attorney or escrow agent. This pass-through coverage is available if the account meets two requirements. First, the records and the title of the account must indicate the existence and nature of the relationship between the attorney, or escrow agent, and the client or principal who owns the funds. Second, the account records must establish what funds are attributable to each client or principal. These other similar escrow accounts are also insured up to $250,000 for each owner of the funds.

It is important to note that the type or extent of the "pass-through" insurance coverage is based on the interest of the owner of the funds. For example, if a husband and wife jointly placed funds into a real estate escrow account, the amount of insured funds would be calculated as if they were held in a joint account.

It is not currently clear whether these amounts would then be aggregated with other amounts held in the same manner, or if they would constitute their own "bucket." In other words, to continue the example, whether the escrow funds would be aggregated with all other funds held in the husband and wife's jointly-owned account and the combined total insured up to $250,000, or if the funds in the joint account and the escrow funds would be separately insured for $250,000 each.

MORE INFORMATION: NCUA **Legal Opinion Letter 17-0424 and 17-0831 analyze two specific account types of to determine if they qualify for pass-through insurance as "other similar escrow" accounts.**

Credit Union Mergers

Under section 745.2(f), the NCUA allows a six-month grace period after the merger of credit unions. This applies to mergers and purchase and assumption agreements. If a member has accounts at both credit unions involved, the member's share insurance coverage will be separate for up to six months.

NCUA has a Q&A in its "Your Insured Funds" booklet discussing this issue:

> *"What effects does the merger of federally insured credit unions have on NCUSIF coverage?*
>
> *Whenever the liability to pay the member accounts of one or more insured credit unions is assumed by another insured credit union, whether by merger, consolidation, other statutory assumption or contract, the insured status of the credit unions whose member account liability has been assumed terminates on the date of receipt by NCUA of satisfactory evidence of the assumption. The separate insurance of member accounts assumed continues for six months from the date the assumption takes effect or, possibly longer in the case of share certificates."*

Credit unions involved in a merger will want to review the merger rules and educate members about their share insurance coverage – especially if a member had accounts at both credit unions.

Credit Union Failure

An important part of the NCUSIF is paying out claims in the event of a credit union failure. The account records of the credit union provide the underlying claim for share insurance coverage. NCUA's Share Insurance FAQ states "the account records of a federally insured credit union are, for example, account ledgers, signature cards, share certificates, passbooks, and certain computer records." NCUA discusses the importance of the credit union account records in section 745.2(c).

Section 745.200 of NCUA's regulations states that the agency might reimburse members for their insured shares in a number of ways – including by check or transfer to another federally-insured credit union:

> "(a) *Payment. In the event of the liquidation of an insured credit union, the Board will promptly determine the insured accountholders thereof and the amount of the insured account or accounts of each such accountholder. Payment may be in cash, or its equivalent, or may be made by making available to each accountholder a transferred account in a new federally-insured credit union in the same community or in another federally-insured credit union or institution in an amount equal to the accountholder's insured account."*

NCUA has indicated it has historically been able to make insured funds available to members within a few days after the closure of a credit union. If the failing credit union is merged into an existing credit union, fully insured members may not face any interruption in services.

If a member has uninsured shares, NCUA will provide a notice to the member stating the reasons for its initial determination and providing the member with a certificate of claim. Members have the ability to appeal the determination of their share insurance coverage.

RESEARCH TIP: The Appendix to section 745 is a helpful resource that contains numerous examples of how to calculate share insurance for different accounts

Death of a Member

Share insurance coverage remains on a member's account for up to six months after the member's death. This allows the remaining owners of the account sufficient time to restructure the account in order to ensure continued share insurance coverage. However, this grace period does not extend to the death of a beneficiary on a revocable trust account. In those situations, the share insurance coverage could be reduced immediately upon the death of the beneficiary.

EXAMPLE

A common example is a joint account with two owners, which can be insured up to $500,000. If either joint owner passes away, the account is still insured at the $500,000 level for up to six months. If the remaining member restructures the account after the death, the regular share insurance rules will apply to the account at that point (even if during the six month grace period). If the account is not restructured within six months, the account will be subject to the regular share insurance rules after the expiration of the six month grace period.

SHARE INSURANCE DISCLOSURES

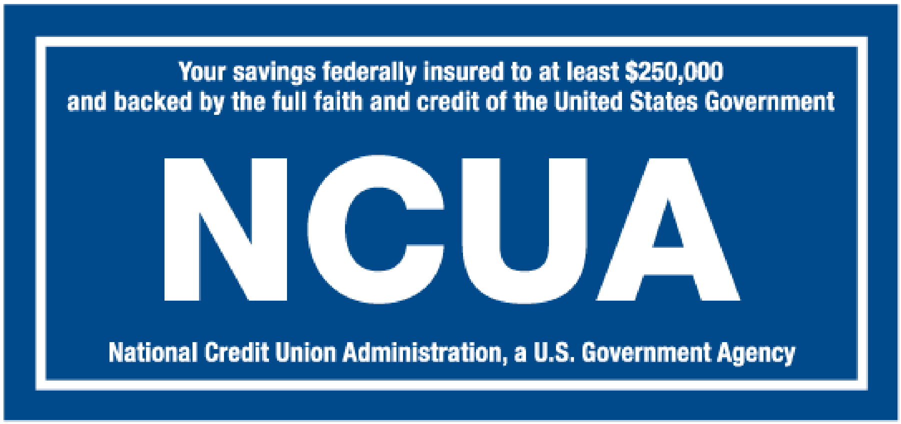
There is often confusion regarding share insurance notices. Some of this stems from the confusing regulatory requirements. Another reason is that the notices are very prominent and easy for examiners, auditors or colleagues to find (or to not find). A third reason is that there is often discussion between compliance officers and marketing staff regarding the inclusion, placement and size of share insurance disclosures, such as the difference between the requirements for NCUA's "official sign" and the requirements for its "official advertising statement."

NCUA's Official Sign

NCUA requires credit unions to display the official sign of their federally-insured status at each teller station or window where funds are accepted and in all the credit union's branches. This *does not* include automated teller machines or point of sale terminals.

The credit union must also include the official sign on Internet pages where the credit union accepts deposits or opens accounts. NCUA has not issued guidance on how this applies to mobile banking or remote deposit capture. Ultimately, the credit union will need to manage those products using a risk-based approach. It might be a good idea to review any mobile banking apps and check with vendors regarding what options a credit union has for displaying the official sign if members have the ability to deposit funds (such as transferring funds among accounts or through remote deposit capture).

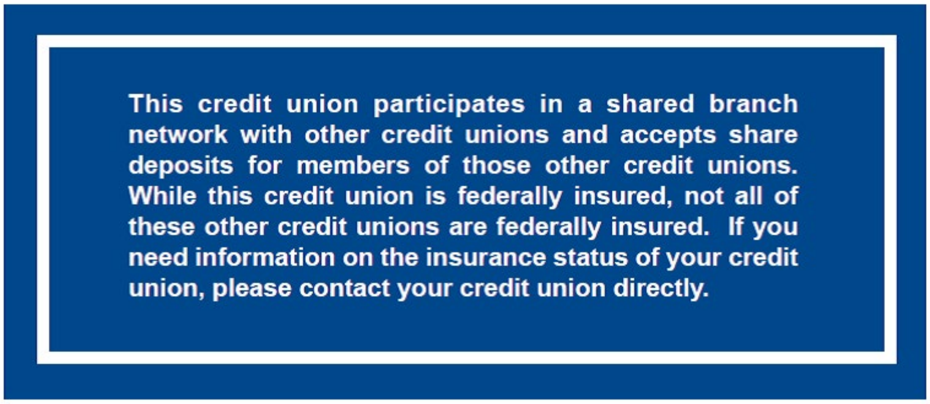
The official sign is located in section 740.4(b) and is:



The sign needs to be in the same font, color and design as the official sign when displayed at the station or teller window where the credit union is accepting deposits. A credit union may alter the font size of the official sign to make it legible on the website page as well as any documents or advertisements provided to members.

MORE INFORMATION: **The NCUA's website contains downloadable versions of the official sign in different file types and with different background colors, as well as versions of the sign in Spanish.**

The official sign can only be used by federally insured credit unions. If a federally insured credit union accepts funds at the same teller station or window which accepts funds for *non-federally insured credit unions*, an additional sign is required. The language for a shared-branching situation is:



Official Advertising Statement

NCUA requires federally insured credit unions to include the official advertising statement on their advertisements. Advertisements are defined broadly as "a commercial message, in any medium, that is designed to attract public attention or patronage to a product or business." Credit unions have options when providing the official advertising statement. The credit union can use one of the following four options:

1. "This credit union is federally insured by the National Credit Union Administration;"
2. "Federally insured by NCUA;"
3. "Insured by NCUA;" or
4. Include the official sign in the advertisement in a size and print that is clearly legible.

NCUA has excluded some advertisements from the requirement for the official advertising statement. For example, the official advertising notice is not required for credit union advertisements for loan products, safe deposit boxes or other ads not relating to the credit union's insured accounts. The official advertising notice is also not required for radio and television advertisements less than 30 seconds in length, listings in directories, as well as credit union stationary and promotional items. The complete list of exceptions are located in section 740.5(c).

NAFCU NOTE

Although the official advertising statement is required on most commercial messages, there are a number of exceptions. This NAFCU *Compliance Blog* post discusses the exceptions and gives examples.

Special Situation – Periodic Statements. Whether the official advertising statement is required on periodic statements depends on whether the credit union's statement includes an advertisement or not. If so, the official advertising statement would be required.

Special Situation – Websites. Section 740.5 requires federally insured credit unions to include the official advertising statement in all advertisements, including on their main internet page. Because the term "advertisement" is defined broadly to cover any message designed to attract attention or patronage, nearly all pages of a credit union's website could be considered advertisements and therefore would be required to include the official advertising statement. However, the exception found in section 740.5(c)(11) notes that the official advertising statement requirement does *not* apply to advertisements for loans, safe deposit services, travelers checks or anything else that does not relate to federally insured accounts. This exception has the practical effect of limiting the official advertising statement requirement to just the credit union's main webpage, as well as any page that advertises federally insured accounts.

NAFCU NOTE

This NAFCU *Compliance Blog* post discusses how the official advertising statement requirements apply to credit union websites.

Note, in December 2013, the Federal Financial Institutions Examination Council (FFIEC) issued guidance on social media, which, among other things, clarified that the existing requirements regarding NCUA membership and share insurance apply equally to advertising and other activities conducted via social media as they do in other contexts.

Disclosures to Members

NCUA's share insurance regulations contain a general requirement to provide notice of share insurance coverage to members. Fortunately, the requirement includes an example of how to comply:

> ***"This may be accomplished by placing either a copy of part 745 of these rules, the appendix, or one or more copies of the NCUA brochure "Your Insured Funds" in each branch office and main office of the credit union. Copies of these materials shall also be made available to members upon request."***

Given the fact that Part 745 and its appendix are not exactly produced in member-friendly formats, this is usually accomplished by having a copy of "Your Insured Funds" in each branch and the credit union's main office.

This also means a credit union does not need to include a copy of the share insurance brochure in its membership packets. A credit union can choose to include it as a member service, but the requirement is that the credit union make the information available upon request. In practice, it is often easier to explain share insurance coverage by showing members NCUA's Share Insurance Estimator and how *their* accounts are covered.

SUMMARY OF BUCKET THEME

As indicated throughout the section, it is sometimes easiest to think about share insurance by the various "buckets" that different types of accounts fall into. Remember, the determination of which bucket will apply depends on the ownership type of the account.

Here is a list of different buckets:

- Single Ownership Accounts (i.e., individual accounts, including sole proprietor accounts and "doing business as/DBA" accounts)
- Joint Ownership Accounts
- Revocable Trust Accounts (i.e., payable-on-death/POD accounts)
- Irrevocable Trust Accounts
- Individual Retirement Accounts (i.e., IRAs and Roth IRAs)
- Keogh Retirement Accounts
- Business Accounts
- Executor or Administrator Accounts
- Guardian or Custodial Accounts

Accounts in each bucket are insured by NCUA separately from accounts in other buckets. This is a key point. A member can have $250,000 in an individual account and $250,000 in an IRA and be fully insured for both accounts as they are in different "insurance buckets."

CHAPTER 2 — MEMBER ACCOUNTS

SECTION 3 — REGULATION CC

OVERVIEW

Regulation CC implements the Expedited Funds Availability Act (EFA Act). The EFA Act generally governs the availability of members' funds that are deposited into transaction accounts as well as certain aspects of the check collection and return processes. The Federal Reserve Board (Board) has rulemaking authority for Regulation CC, although section 1086 of Dodd-Frank amended the EFA Act to provide the CFPB with joint rulemaking authority with the Board over certain consumer-related EFA Act provisions.

Regulation CC is divided into several subparts. Subpart A defines terms and outlines enforcement authority. Subpart B sets the timing rules for when funds deposited into transaction accounts must be made available for use and requires disclosures regarding funds availability. Subpart C contains rules regarding the collection and return of checks and electronic checks. Subpart D, which was added to Regulation CC in 2004 to implement the Check Clearing for the 21st Century Act (Check 21), establishes liability and responsibilities for financial institutions that create or receive substitute checks.

DEFINITIONS

This section will not cover all the definitions of Regulation CC, but the following terms are important for understanding the regulation. These definitions can be found in section 229.2 of the regulation.

Account. For purposes of the funds availability rules, the definition of account refers to Regulation D's definition of transaction account and provides that the term "account" generally includes accounts where the account holder is permitted to make transfers and withdrawals. The staff commentary notes that the definition of "account" in the EFA Act suggests that it is intended to apply only to accounts that have unlimited third-party transfers. This definition of account specifically excludes savings accounts as defined by Regulation D. The definition is not limited to consumer accounts – it applies to business and fiduciary accounts as well. Thus, Regulation CC's funds availability rules apply to consumer, business and organizational transaction accounts, but do not apply to savings accounts.

For the substitute check rules, "account" means any deposit, including savings accounts and certificate accounts.

Consumer Account. A consumer account is one used primarily for personal, family or household purposes.

Business Day. Every day except Saturday, Sunday and federal holidays.

Banking Day. The part of any business day for which the credit union is open for carrying on substantially all its banking functions.

Bank. The term "bank" means any depository institution, including credit unions.

Contractual Branch. A branch of another bank that accepts a deposit on your credit union's behalf. Credit unions often use contractual branches – a shared branch is a contractual branch.

AVAILABILITY OF FUNDS AND DISCLOSURE REQUIREMENTS

Regulation CC provides rules for when various deposits must be made available. Some types of deposits must be given next-day availability, while others must be made available according to Regulation CC's availability schedule. When funds must be made available is measured by the number of business days following the banking day on which the deposit is made. As a result, one of the most important details in figuring out when funds must be made available is determining when the funds are considered deposited.

When Funds Are Considered Deposited

Section 229.19 of Regulation CC is labeled "Miscellaneous" but it should not be overlooked. Among other things, it provides the rules for determining when funds are considered deposited:

- Section 229.19(a)(1) states funds deposited at a staffed facility, ATM or contractual branch are considered deposited when they are received at the facility, ATM or contractual branch (or a proprietary ATM of the contractual branch). If the credit union has a drop box in its lobby where members may place deposits, such deposits are generally considered deposited when placed in the box. However, the credit union may treat deposits to lobby boxes the same as deposits to night deposit boxes if it provides a notice on the lobby box that states when the deposits will be considered deposited.
- Section 229.19(a)(2) provides that funds mailed to the credit union are considered deposited the day they are received by the credit union. The day they are received is the day the mail is delivered

to the credit union, even if the mail is initially delivered to a mailroom rather than the check processing area.

- Section 229.19(a)(3) explains funds deposited to a night depository, lock box or similar facility are considered deposited on the day on which the deposit is removed from such facility and is available for processing by the credit union.
- Section 229.19(a)(4) states if funds normally are removed from the ATM no more than two times each week, funds deposited at an ATM that is not on, or within 50 feet of, the premises of the depositary bank are considered deposited on the day the funds are removed from the ATM.
- Under section 229.19(a)(5), funds may be considered deposited on the next banking day, in the case of funds that are deposited:
    - On a day that is not a banking day for the depositary bank; or
    - After a cut-off hour set by the depositary bank for the receipt of deposits of 2:00pm or later, or for the receipt of deposits at ATMs, contractual branches, or off-premise facilities, of 12:00pm or later. A credit union is not required to stay open until 2pm. If it closes before 2pm, deposits received after the closing may be considered deposited on the next banking day. Different cut-offs may be established for different types of deposits.

EXAMPLE

A credit union may set a 2:00pm cut-off for receipt of check deposits and a later time, such as 4:00pm for receipt of wire transfers. Also, ATMs may have a different cut-off time than over-the-counter deposits. So, a credit union may set a 1:00pm cut-off time for ATM deposits and a cut-off time of 3:00pm for in-person deposits.

Timing

Section 229.19(b) requires funds must be made available at the start of the business day. Thus, the funds must be made available by the later of 9:00am or the time the credit union's teller facilities (including ATMs) are available for account withdrawals on the day they are scheduled to be made available.

EXAMPLE

If the credit union has 24-hour ATM service and teller facilities that open at 10:00am, funds must be available for ATM withdrawal at 9:00am and available for withdrawal by 10:00am at the teller lines. Note the timing is different for the $450 rule discussed later.

Availability of Funds

Next-Day Availability

Section 229.10 of Regulation CC spells out all of the requirements for next day availability. Cash, electronic payments and certain check deposits must be made available for withdrawal the business day after the banking day on which they were received. These checks are: US Postal Service money orders; Federal Reserve Bank and Federal Home Loan Bank checks; state or local government checks deposited at an institution in the same state as the payor; on-us checks; and cashier, teller or certified checks. To qualify for next-day availability, these checks must be deposited in person at a staffed teller station to an account held by the payee. For next-day availability, Treasury checks must be deposited to an account held by the payee, but do not need to be deposited in person. Credit unions may require that cashier's, certified and teller's checks, as well as state and local government checks be deposited with a special deposit slip to receive next-day availability. In general, if the checks do not meet the criteria for next day availability, they will be treated as local checks subject to the availability rules in section 229.12.

NAFCU NOTE

NAFCU published a *Compliance Blog* post answering some frequently asked questions regarding Regulation CC's funds availability rules.

$225 Rule. Under section 229.10(c)(1), the credit union must make available the next business day the lesser of $225 or the aggregate of all check deposits not already subject to next-day availability. This rule does not apply to checks deposited at nonproprietary ATMs.

EXAMPLE

If the member deposited $225 by check, the credit union would need to make the entire $225 available by the next business day. If the member deposited a $100 check and a $300 check, the credit union would need to make $225 available the next business day. The remaining amount would be made available on the second business day.

Second-Day Availability

Section 229.12 provides the rules for second-day availability. There used to be a distinction between local and nonlocal checks, and you will still find rules for nonlocal checks in the regulation. Nonlocal checks were those checks payable at or through banks located in different check processing regions than the credit union. The Federal Reserve has removed the nonlocal check category. By eliminating all but one check processing center, all checks are now considered local checks. Local checks must be made available for withdrawal no later than the second business day following the banking day on which the checks are deposited. This would be the amount in excess of the first $225 discussed above. In addition, checks that do not satisfy the requirements for next-day availability must be made available on the second business day following the day of deposit.

$450 Rule. This rule, found in section 229.12(d), determines when a credit union must make check deposits available for cash withdrawals. For purposes of this rule, cash withdrawals include electronic payment, issuance of a cashier's or teller's check, or certification of a check, or other irrevocable commitment to pay. In essence, the credit union needs to make a local check available for check withdrawals on the second business day after the day of deposit; however, $450 of the deposited funds need to be available for cash withdrawals no later than 5:00pm on that same day. At the start of the third business day after the day of deposit, the member must be able to withdraw the entire amount in any manner.

EXAMPLE

John Member deposited a $1,000 check on Monday. On Tuesday at 9:00am, $225 of that must be available for cash and/or check withdrawals. On Wednesday, the remaining $775 must be available for check-writing purposes by 9:00am and $450 of it needs to be available for cash withdrawal by 5:00pm. On Thursday at 9:00am, the member must be able to withdraw the entire amount in any manner.

Nonproprietary ATMs. According to section 229.12(f), cash or check deposits at nonproprietary ATMs must be made available no later than the fifth business day after the day of deposit. The provisions requiring a depository bank to make up to $225 of an aggregate daily deposit available for withdrawal on the first business day after the banking day of deposit do not apply to deposits at a nonproprietary ATMs. The definition states a nonproprietary ATM is one that: (a) is not owned or operated by the credit union, (b) is not located on the credit union's premises and (c) is not located within 50 feet of the credit union's premises and is identified as being owned or operated by a third party.

Exceptions

Section 229.13 provides six exceptions to the general availability schedules. These exceptions allow credit unions to extend the hold period for deposits that carry a higher risk to the institution due to their size, collectability or the member's deposit history (or lack thereof).

- **New Accounts.** Under section 229.13(a), an account is considered "new" for the first 30 days it is open. This exception is intended for members that do not currently have a transaction account at the credit union. Thus, if a member already has a transaction account at the credit union, which has been open for at least 30 days, then any additional account would not be a "new" account for purposes of this exception. Under this exception, next-day availability applies to cash, electronic deposits and the first $5,525 of most other next-day items; the remaining funds of the next day items must be made available on the ninth business day. The credit union may choose its availability schedule for on-us checks and local checks.

MORE INFORMATION: If the member has a savings account at the credit union that does not meet the definition of an account, and the member then opens a checking account – the checking account would be subject to the new account exception. For more information, check out the commentary to Regulation CC, specifically comment 229.13(a)-1.

- **Large Deposits.** Under section 229.13(b), the credit union may extend the hold periods when funds, other than cash or electronic deposits, over $5,525 are deposited by a member in any one banking day. The extended hold may be placed on funds in excess of $5,525, and the credit union may aggregate deposits made by that member to any of his or her accounts, even joint accounts.
- **Redeposited Checks.** Under section 229.13(c), the credit union can place an extended hold on a check that had previously been deposited and returned unpaid. This exception does not apply to checks that were returned because they were post-dated and are no longer post-dated or to checks that were returned due to a missing indorsement and the indorsement is no longer missing.
- **Repeated Overdrafts.** If the member's account(s) has been repeatedly overdrawn, the availability rules for checks do not apply for 6 months after the last overdraft. Under section 229.13(d), there is a specific definition for what constitutes a repeatedly overdrawn account. The credit union may consider an account to be repeatedly overdrawn if:

    - On six or more banking days within the preceding six months, the account balance is negative, or the account balance would have become negative if checks or other charges to the account had been paid; or

- On two or more banking days within the preceding six months, the account balance is negative, or the account balance would have become negative, in the amount of $5,525 or more, if checks or other charges to the account had been paid.
- **Reasonable Cause to Doubt Collectability.** Under section 229.13(e), this exception can apply when the credit union has reasonable cause to believe the check is uncollectible. This belief must be based on a set of facts particular to the check and not on the fact that the check is of a particular class or is deposited by a particular class of persons. This exception could not be applied to a check simply because it is a cashier's check, absent other facts particular to that check.
- **Emergencies.** Hopefully, a credit union will never have to use the exception under section 229.13(f), as it permits the credit union to place an extended hold on deposits in cases of emergencies beyond the credit union's control.

Exception Hold Times. Except for new accounts and emergency holds, the regulation provides a safe harbor for what is considered a reasonable extended hold. It defines a "reasonable period of time" as one additional business day for on-us checks, five additional business days for local checks and six additional business days for deposits at nonproprietary ATMs. Credit unions may impose longer holds but have the burden of proving the period is reasonable.

RESEARCH TIP: Federal Reserve's Consumer Compliance Handbook section on the Expedited Funds Availability Act and the FDIC's Expedited Funds Availability Act chapter in its Consumer Compliance Examination Manual provide several graphics and visuals that apply the funds availability rules and exception holds.

Notice of Extended Hold. A credit union usually must provide notice to a member when it invokes one of the above exceptions. Section 229.13(g) states the general notice should be provided when the credit union invokes the large deposit, redeposited checks, repeated overdrafts and reason to doubt collectability exceptions. The general notice must contain the:

- Account number (the last four digits of a customer's account will suffice);
- Date of the deposit;
- Amount that will be delayed;
- Reason for the delay; and
- Day the funds will be available or information sufficient to indicate when funds will be available and the amounts that will be available at those times.

These extended hold notices should be provided at the time of the deposit, unless (1) the deposit is not made in person to an employee of the credit union or (2) the credit union uncovers facts after the deposit authorizing the credit union to invoke one of the exceptions.

Under section 229.13(g)(2)-(3), there are two alternative notices to the general notice required for the large deposit, redeposited checks, repeated overdrafts and reason to doubt collectability exceptions. First, for non-consumer accounts, the credit union may provide a one-time exception notice for large deposits and redeposited checks that explains the reasons these exceptions may be invoked and the time period of the delay. Second, if the credit union is invoking the repeated overdrafts exception, it may provide one notice to the member that includes the above required information as well as the duration of the exception.

Section 220.13(g)(4) allows for a different notice when a credit union invokes the emergency conditions exception notice:

> *"[I]t must provide the depositor with notice in a reasonable form and within a reasonable time given the circumstances. The notice shall include the reason the exception was invoked and the time period within which funds shall be made available for withdrawal, unless the depositary bank, in good faith, does not know at the time the notice is given the duration of the emergency and, consequently, when the funds must be made available. The depositary bank is not required to provide a notice if the funds subject to the exception become available before the notice must be sent."*

RESEARCH TIP: When researching a Regulation CC question, it is important to first understand what the credit union needs to disclose and what the hold times are for checks? If someone is wondering how long they can hold a check, start with the standard availability times and then ascertain if any exceptions fit. If an exception applies, then how much extra time does it give the credit union and so on. For disclosure questions, it is necessary to know the disclosure requirements and the credit union's funds availability policies.

Funds Availability Disclosures

General Disclosure Requirements

Section 229.15(a) requires disclosures to be clear and conspicuous, in writing, and except for disclosures posted where employees accept deposits, at ATMs or on preprinted deposits slips, be in a form the consumer may keep. If disclosures are contained in a document that sets forth other account terms, they must be highlighted in some way (i.e., under a separate heading).

Specific Availability Policy Disclosure

Section 229.16 requires credit unions to provide members with a disclosure, before an account is opened, that describes the funds availability policy followed by the credit union in most cases. The disclosure should include:

- A summary of the availability policy;
- A description of the categories of deposits or checks used to determine a delay in availability; when funds from those categories will be available; and an explanation of how to determine the category to which a deposit belongs;
- A description of any exception holds the credit union may impose;
- A description of any case-by-case hold policy; and
- A description of how a member may differentiate between a proprietary and non-proprietary ATM.

Appendix C to Regulation CC contains model forms that help demonstrate the regulatory disclosure requirements.

EXAMPLE

A credit union that has a case-by-case hold policy and makes most deposits available on the next business day except in case-by-case situations, or under one of the exception holds, could look to Model Form C-3 in Appendix C for an example of how to disclose such a policy.

Many credit unions have a policy of making deposited funds available for withdrawal sooner than required. This allows credit unions to extend the time when funds are available up to the time periods allowed under Regulation CC on a case-by-case basis in accordance with section 229.16(c)(1).

If a credit union exercises its ability to use a disclosed case-by-case hold, Regulation CC generally requires notice as described in section 229.16(c)(2). Under the regulation, the notice should be provided to the member at the time of deposit, unless the deposit is not made in person to an employee of the credit union, or the credit union is unable to determine whether to exercise the case-by-case hold until after the deposit is made. In those cases, the notice should be mailed or delivered to the member no later than the first business day following the banking day the deposit is made.

Additional Disclosure Requirements

Deposit Slips. Section 229.18(a) requires preprinted deposits slips to include a notice that deposits may not be available for immediate withdrawal.

Locations Where Employees Accept Consumer Deposits. Section 229.18(b) requires such locations to have posted, in a conspicuous place, a notice that provides the funds availability policy for deposits. This notice is not required at drive-through windows or night depository boxes.

MORE INFORMATION: The staff commentary notes that the disclosure does not need to be at each teller window but must be placed in a location where consumers are likely to see it before making their deposits (i.e., at the teller line).

ATMs. Section 229.18(c) requires credit union to post at its ATMs a notice that funds deposited at the ATM may not be available for immediate withdrawal. If the credit union operates an off-premises ATM and does not remove deposits from it more than twice a week, it must disclose at or on the ATM the days on which funds will be considered received.

Upon Request. Section 229.18(d) requires the specific availability disclosure to be provided before account opening must also be provided to anyone upon oral or written request.

Changes in Policy. Section 229.18(e) requires the credit union to provide a change in terms notice to its consumer account holders at least 30 days in advance of the effective date of the change. However, if the change expedites funds availability, the credit union may provide the change in terms disclosure not later than 30 days after the change. The staff commentary permits the notice to be provided in any form so long as it is clear and conspicuous. If the credit union delivers it in a new set of account disclosures, the change must be highlighted in some manner.

Relation to State Law

Section 229.20 and its commentary govern preemption. The EFA Act indicates that any state law that provides for availability in a shorter period of time than required by federal law is applicable to all federally insured institutions in that state, including federally chartered institutions.

MORE INFORMATION: The provision requiring federally chartered institutions to follow more favorable state laws applies only to state laws in effect on or before September 1, 1989. In other words, state laws that went into effect after that date are preempted by Regulation CC.

The commentary to section 229.20(a) clarifies if a state law provides shorter availability only for deposits in accounts in certain categories of banks, such as commercial banks, the superseding state law continues to apply only to those categories of banks, rather than to all federally insured banks in the state.

As stated in section 229.20(b), provisions of state law that are inconsistent with the EFA Act and Regulation CC are preempted. Preemption does not require a determination by the Federal Reserve Board to be preempted. However, an interested party in a state may request a preemption determination. Any such determination will apply only to Subparts A and B of Regulation CC. Such determinations are found in Appendix F to the regulation.

COLLECTION OF CHECKS

The rules regarding the collection of checks in Subpart C of Regulation CC are intended to speed the check return and collection process. These rules cover the return responsibilities of paying and returning banks in this process and require the expeditious return of checks, as well as the warranties and liabilities involved in the check collection process. Subpart C applies to "electronic checks" in addition to paper checks and paper returned checks. Electronic checks are distinguished from "electronically-created items" which are not derived from a paper check. For purposes of discussing

Subpart C and the collection of checks, the word "check" should be read to refer to both paper and electronic checks.

MORE INFORMATION: "Electronic checks" are defined as "an electronic image of, and electronic information derived from, a paper check [that is] sent to a receiving bank pursuant to an agreement between the sender and the receiving bank [and] conforms with" certain national standards.

The Expeditious Returns Rule

Regulation CC requires the expeditious return of checks. Under section 229.31(b), for a return to be considered expeditious, it must be sent in a manner such that the check would normally be received by the depositary bank not later than 2:00pm local time on the second business day after the check was presented to the paying bank. The commentary to section 229.31(b) clarifies that actual receipt of the returned check by the depositary back is not required; the paying bank need only return the check in a manner that would normally be received by the deadline. For example, a paying bank may rely on a returning bank's return deadlines and availability schedules for electronic returned checks and returned checks scheduled to be delivered to the depositary bank. Under section 229.31(c), the paying bank also must provide a notice of nonpayment if the amount of the check is $5,000 or more. The notice of nonpayment must include the information from the check's MICR line; payee's name; amount; date of the depositary bank's indorsement; depositary bank's name, routing number and trace or sequence number; and the reason for nonpayment. The notice is also due to the depositary bank by 2:00pm (according to the depositary bank's local time).

If the paying bank fails to return a check in an expeditious manner, it may be liable to the depositary bank. Section 229.33(a) explains the paying bank is liable only if the depositary bank has procedures in place that would allow a check to be returned electronically, directly or indirectly, by commercially reasonable means. The burden of proving that these arrangements exist is on the depository bank asserting a claim. If a depositary bank does not have policies and procedures in place to receive returned checks electronically, even indirectly, it may forfeit its right to bring a claim against the paying bank for its failure to return the check in an expeditious manner.

Forged and Altered Checks

Section 229.38(i) includes a rebuttable presumption that a check has been altered when there is a dispute over whether the check has been altered or forged and the original check is not available. This presumption is necessary because of the difficulty that may exist in proving whether an original check contains an alteration or forgery given that the collection and return of checks now overwhelmingly occurs electronically. The presumption can be overcome by proving by a preponderance of the evidence that the check has been forged or by providing the original check for inspection.

RDC Indemnity

Section 229.34(f) of Regulation CC also includes a remote deposit capture (RDC) indemnity. A credit union that accepts deposit of an electronic image or other electronic information related to a paper check for deposit via RDC; does not receive the paper check; receives settlement for the check deposited via RDC; and does not receive a return of the check unpaid is obligated to indemnify a depositary bank that subsequently accepts the paper check for deposit and suffers a loss because the check has already been paid. But an indemnity claim is not available if the paper check that was accepted for deposit contained a restrictive indorsement inconsistent with the means of deposit.

NAFCU NOTE

This NAFCU *Compliance Blog* post provides additional information about the presumption for forged or altered checks while this post further explains restrictive indorsements for RDC indemnity.

Unfortunately, there is no bright-line rule about what constitutes a restrictive indorsement for the purposes of section 229.34(f). In the preamble to the final rule, the Federal Reserve Board explained that “for mobile deposit only” is an example of a restrictive indorsement and the commentary provides another example: "for mobile deposit at Depositary Bank A only." As these are just examples, other indorsements may also be sufficient. State law may also provide some guidance about what constitutes a restrictive indorsement.

SUBSTITUTE CHECKS

General Provisions

A substitute check for which a credit union has provided the warranties described below is the legal equivalent of an original check for all persons and all purposes, including any provision of federal or state law. Under section 229.52(a)(1)(i), a substitute check:

- Accurately reflects all the information on the front and back of the original check as of the time the original check was truncated; and
- Bears the legend "This is a legal copy of your check. You can use it the same way you would use the original check."

A substitute check that is the legal equivalent of the original check shall be subject to any provision of Regulation CC, the Uniform Commercial Code and other applicable law as if it were the original check, to the extent that such law is not inconsistent with Check 21 or Subpart D of Regulation CC.

A reconverting bank is the bank (as that term is defined in section 229.2(zz)) that either converts the check to a substitute check, or if the person who converts the check is not a bank, the first bank to handle the substitute check. A reconverting bank must ensure that the substitute check bears all indorsements applied by all parties that previously handled the check (in any form), identifies the reconverting bank and identifies the bank that truncated the original check.

Warranties and Indemnity

Section 229.52 requires any credit union that transfers, presents or returns a substitute check (or a paper/electronic representation of a substitute check) and receives consideration for that check warrants that the substitute check meets the legal equivalence requirements and that a check that has already been paid will not be presented for subsequent payment.

Section 229.53 follows with maintaining such a credit union will indemnify any recipient or subsequent recipient of the substitute check for any loss incurred by any recipient if that loss occurred due to the receipt of a substitute check in lieu of the original check.

Expedited Recredit

A consumer may make a claim for expedited recredit under section 229.54 only for a substitute check that he or she has received and for which the credit union charged his or her account. To make such a claim, the consumer must assert in good faith:

- The credit union holding the account charged the account for a substitute check provided to the consumer;
- The substitute check was not properly charged to the consumer's account or the consumer has a warranty claim with respect to the substitute check;
- The consumer has suffered a loss as a result; and
- Production of the original check or sufficient copy of the original check is necessary to determine whether or not the substitute check was improperly charged, or the consumer's warranty claim is invalid.

EXAMPLE

The staff commentary provides excellent examples demonstrating these rules: "A consumer who received a substitute check believed that he or she wrote the check for $150, but the credit union charged his or her account for $1,500. The amount on the substitute check the consumer received is illegible. If the substitute check contained a blurry image of what was a legible original check, the consumer could have a claim for a breach of the legal equivalence warranty in addition to an improper charge claim. Because the amount of the check cannot be determined from the substitute check provided to the consumer, the consumer, if acting in good faith, could assert that the production of the original check or a better copy of the original check is necessary to determine the validity of the claim. The consumer in this case could attempt to recover his or her losses by using the expedited recredit procedure. The consumer's losses recoverable under section 229.54 could include the $1,350 he or she believed was incorrectly charged plus any improperly charged fees associated with that charge, up to $150 (plus foregone interest on the amount of the consumer's loss if the account was an interest-bearing account). The consumer could recover additional losses, if any, under other law, such as U.C.C. 4–401 and 4–402."

To make a claim under section 229.54(b), the consumer must submit his or her expedited recredit claim to the credit union within 40 calendar days of the later of the calendar day on which the credit union mailed or delivered: (1) the periodic account statement containing information concerning the transaction giving rise to the claim, or (2) the substitute check giving rise to the claim. The mailing or delivery of a substitute check could be in connection with a regular account statement, in response to a consumer's specific request for a copy of a check or in connection with the return of a substitute check to the payee.

The claim must include the following in accordance with section 229.54(b)(2):

- A description of the claim, including a reason why the consumer believes his or her account was improperly charged for the substitute check or the nature of his or her warranty claim;
- A statement that the consumer suffered a loss and an estimate of such loss;
- The reason why production of the original check or a sufficient copy is necessary; and
- Sufficient information to allow the credit union to identify the substitute check and investigate the claim.

The regulation permits a credit union to require that a claim is submitted in writing. If a consumer makes an oral claim to the credit union, the credit union must inform the consumer of the written requirement at that time.

A credit union that receives a claim that satisfies the requirements of section 229.54(b) is required to act on the claim within ten days of receiving it. If the credit union determines that the claim is valid, it must recredit the consumer's account. The recredit should be in the amount of the loss, up to the amount of the substitute check, plus interest on that amount if the account is a dividend-bearing account. The credit union must then notify the consumer of the recredit. If the credit union determines that the claim is not valid, it must notify the consumer of this determination.

If the credit union has not taken action by the 10th business day after receiving the claim, section 229.54(c)(3) requires the credit union to recredit the consumer's account for the amount of the consumer's loss, up to the lesser of the amount of the substitute check or $2,500, plus dividends on that amount if the account is a dividend-bearing account and send the consumer a notice of the recredit. In addition, the credit union shall recredit the consumer's account for the remaining amount of the consumer's loss, if any, up to the amount of the substitute check, plus dividends if the account is a dividend-bearing account, no later than the end of the 45th calendar day after the banking day on which the credit union received the claim and send to the consumer a notice of the recredit, unless the credit union prior to that time has determined that the consumer's claim is or is not valid.

Consumer Awareness

The credit union must provide a notice to its members that describes that a substitute check is the legal equivalent of an original check under section 229.57. The notice must also describe that recredit rights apply when the consumer in good faith believes that a substitute check was not properly charged to the account.

Under section 229.57(b), the credit union must provide this disclosure to members at the time the member relationship is initiated for any member that receives paid substitute or original checks with his or her statement. Members that receive substitute checks only on an occasional basis shall receive the disclosure when they request an original or copy of a check and receive a substitute check. The credit union shall provide the disclosure no later than at the time it provides the substitute check. If a member receives a returned substitute check, the credit union shall provide the notice at the time it provides the substitute check.

CHAPTER 2 — MEMBER ACCOUNTS

SECTION 4 — TRUTH IN SAVINGS

OVERVIEW

NCUA's Truth in Savings regulation (12 CFR Part 707) implements the Truth in Savings Act. It became effective in 1993 and has been amended numerous times through the years. NCUA's Truth in Savings regulation should not be confused with Regulation DD (12 CFR Part 1030), which historically was overseen by the Federal Reserve Board and implements the Truth in Savings Act for banks and thrifts. Regulation DD transferred to the CFPB in 2011, but Part 707 did not. Congress mandated that NCUA's regulation be "substantially similar" to Regulation DD. Therefore, NCUA typically follows any changes that the CFPB may make.

While the regulations are practically identical, NCUA's regulations govern the activities of credit unions, and should always be the primary research resource, as there are some differences that address the uniqueness of the credit union industry. These will be addressed throughout this section when necessary.

The purpose of Truth in Savings is to enable consumers to make informed decisions about their accounts at credit unions through the use of uniform disclosures. The disclosures promote comparison shopping by informing consumers about the fees, annual percentage yield (APY), dividend rate and other terms for accounts.

The Truth in Savings regulation contains several disclosure requirements such as account opening disclosures, change in terms notices, periodic statements (as applicable), account maturity notices for term share accounts, etc. The regulation also includes requirements concerning advertising, overdraft protection practices, the payment of dividends and record retention. These requirements will be reviewed throughout this section.

SCOPE AND DEFINITIONS

NCUA's version of Truth in Savings generally applies to all credit unions whose accounts are either insured, or eligible to be insured, by the National Credit Union Share Insurance Fund (NCUSIF). The entire scope of NCUA's Truth in Savings is defined in section 707.1(c).

In addition to section 707.1 of the NCUA's Truth in Savings regulation, one of the best places to look to understand the scope of consumer protection regulations is the "definitions" section. NCUA narrows the scope of its regulation further by defining certain terms, products and services in section 707.2.

Also, never forget to check the Official Staff Interpretations, which are located in Appendix C to Part 707. This staff commentary often contains important clarifications and examples.

Covered Accounts

Two important definitions contained in section 707.2 are "account" and "member." The definition of account is "a share or deposit account at a credit union held by or offered to a member or potential member. It includes, but is not limited to, accounts such as share, share draft, checking and term share accounts." The staff commentary on the definition of "account" provides examples of covered accounts, such as IRAs, accounts held by a parent or guardian for a minor (such as under a state's Uniform Transfer Gift to Minor Act) and payable-on-death accounts.

Covered accounts **do not include** mortgage escrow accounts for collecting taxes and property insurance, accounts opened by an executor in the name of a decedent's estate, and trust accounts opened by a trustee under a formal written trust agreement. The staff commentary gives other clarifications, but these cover most situations.

Section 707.2 defines "member" as any of the following: 1) a natural person member who holds an account primarily for personal, family or household purposes; 2) a natural person nonmember who holds, or is offered, an account primarily for personal, family or household purposes, either jointly with a natural person member or in a low-income designated credit union; or 3) a natural person nonmember who has or is eligible to have a deposit account in a state-chartered credit union.

Putting these definitions together helps to understand the scope of the Truth in Savings regulation. A covered account includes an account held by a "member." A member only includes natural persons who hold accounts primarily for personal, family or household purposes. Therefore, Truth in Savings does not apply to accounts held by non-natural persons (i.e., business associations). In addition, it does not apply to accounts held for commercial purposes (i.e., a purpose other than personal, family or household purposes). A credit union may follow Truth in Savings for non-covered entities or accounts if it wishes, but is not required to do so.

Use of Synonyms

A credit union can use synonyms to name accounts, as long as the name does not mislead members. NCUA indicates that the purpose of the Truth in Savings regulation is not to limit a credit union's descriptions of accounts. The staff commentary to the definition of "account" explains that credit unions can use adjectives and trade names to describe accounts.

For example, NCUA indicates the following synonyms are appropriate to use:

- **Checking Account** may be used to describe a share draft account.
- **Money Market Account** may be used to describe money market share accounts.
- **Savings Account** may be used to describe regular share and share accounts.
- **Share Certificate, Certificate Account or Certificate** may be used to describe term share accounts.

However, NCUA indicates that the following synonyms are prohibited, as they do not accurately describe the account:

- **Deposit Account** may not be used to describe a share account. Funds paid into a share account establish members as owners of the credit union. Conversely, funds paid into a deposit account do not establish an ownership interest in a financial institution.
- **Interest** may not be used to describe dividends. Dividend payments are a return on an equity (ownership) investment. Interest payments are a return on a debt investment (deposits). State-chartered credit unions may offer interest on accounts if permitted by state law.
- **CD or Certificate of Deposit** may not be used to describe a share certificate. Again, credit unions offer share accounts – not deposit accounts. State-chartered credit unions may offer certificates of deposit if permitted by state law.

RESEARCH TIP: In addition to the list of appropriate synonyms, the staff commentary to the definition of "account" outlines the types of accounts that are subject to NCUA's Truth in Savings rule and the types of accounts that are generally excluded from coverage.

GENERAL DISCLOSURE REQUIREMENTS

Section 707.3 outlines the general requirements for account and periodic statement disclosures. These disclosures are required to be:

- Clearly and conspicuously in writing (or electronically in accordance with the E-SIGN Act);
- In a form the member or potential member may keep;
- Clearly identifiable for different accounts, if disclosures for different accounts are combined;
- Reflective of the terms of the legal obligation between the member and the credit union;
- Available in English upon request if the disclosures are made in languages other than English; and

- Consistent. The same terminology must be used to describe terms or features that are required to be disclosed. For example, if a monthly fee is described as a "monthly service fee" in account opening disclosures, the periodic statements and change-in-terms notices must also refer to this fee as a "monthly service fee."

Note that if an account is held by more than one member or consumer, disclosures may be made to any one of them.

In addition, if a credit union chooses to provide rate information orally, it must state the annual percentage yield and may state the dividend rate. However, the credit union may not state any other rate. The advertising rules do not cover an oral response to a rate inquiry.

Relation to Regulation E

Disclosures required by Regulation E (12 CFR Part 1005) that are also required by Truth in Savings may be substituted for the disclosures required by Truth in Savings. In other words, compliance with Regulation E satisfies the disclosure requirements of Truth in Savings. For instance, when a credit union changes a term that triggers a notice under Regulation E and Truth in Savings, and the credit union complies with the timing and disclosure rules of Regulation E for sending change-in-terms notices, it has complied with both regulations.

Rounding and Accuracy Rules for Rates and Yields

There are also requirements in section 707.3(f) regarding the rounding and accuracy of rates and yields.

Rounding. The annual percentage yield (APY), the annual percentage yield earned (APYE) and the dividend rate must be rounded to the nearest one-hundredth of one percentage point (0.01 percent) and expressed to two decimal places. (For account disclosures, the dividend rate may be expressed to more than two decimal places.) For example, if an annual percentage yield is calculated at 5.644 percent, it must be rounded down and disclosed as 5.64 percent. By contrast, if the annual percentage yield is calculated at 5.645 percent, it must be rounded up and disclosed as 5.65 percent.

Accuracy. The disclosed APY (and the APYE) will be considered accurate if it is not more than one-twentieth of one percentage point (0.05 percent) above or below the actual APY (and the APYE).

ACCOUNT DISCLOSURE REQUIREMENTS

Content of Account Disclosures

Account disclosures must include, as applicable, information as outlined by section 707.4. Disclosures need to include information about the following areas:

- **Rate Information.** A credit union must disclose the annual percentage yield and dividend rates as applicable. Appendix A provides details on calculating the APY.
- **Compounding and Crediting.** A credit union must disclose the frequency with which dividends are compounded and credited and the dividend period. If members will forfeit dividends if they close an account before accrued dividends are credited, the disclosures must state that dividends will not be paid in these circumstances. A credit union must also include a statement that dividends are paid from current income and available earnings, after required transfers to reserves at the end of a dividend period.
- **Balance Information.** A credit union must disclose any minimum balance requirements, and how the balance is determined to avoid fees or to obtain the APY. In addition, this section will provide an explanation of the balance computation method.
- **Fees.** A credit union must disclose the amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed. Examples of fees that must be disclosed are:
  - Maintenance fees, such as monthly service fees;
  - Fees to open or to close an account;
  - Fees imposed upon dormant and inactive accounts;
  - Fees related to deposits or withdrawals, such as fees for use of the institution's ATMs;
  - NSF fees; and
  - Fees for special services, such as stop-payment fees, fees for balance inquiries or verification of share and deposits, fees associated with checks returned unpaid, fees for regularly sending to members share drafts that otherwise would be held by the credit union and overdraft line of credit access fees (if charged against the share account).

  NCUA also provides examples in the staff commentary of certain fees that are not required to be disclosed by the Truth in Savings regulation. For example:

  - Fees for services offered to members and nonmembers alike, such as fees for travelers checks, wire transfers, ACH transfers, processing of credit card cash advances or handling of U.S. Savings Bond Redemption, and

  - Incidental fees, such as fees associated with state escheat laws, garnishment or attorney's fees, to change names on an account, to generate a mid-cycle periodic statement, to wrap loose coins, for photocopying, for statements returned to the credit union because of wrong address and locator fees.
- Transaction Limitations. A credit union must disclose any limitations on the number or dollar amount of withdrawals or deposits. Examples of such limitations include the limits on the number of checks that may be written, limits on withdrawals from a share certificate and any limits on the number of transfers to/from the account.
- Features of Term Share Accounts. For term share accounts (i.e., share certificates), a credit union must disclose information about the following features:
  - Time requirements;
  - Early withdrawal penalties;
  - Disclosures related to the withdrawal of dividends prior to maturity; and
  - Renewal policies, such as whether an account will or will not renew automatically at maturity.
- Bonuses. For bonuses, a credit union must disclose:
  - The amount or type of any bonus;
  - When the bonus will be provided; and
  - Any minimum balance and time requirements to obtain the bonus.

Appendix B of Truth in Savings contains model account disclosures.

Delivery of Disclosures

Account Opening. Under section 707.4(a)(1) a credit union must provide account disclosures to a member or consumer before an account is opened or a service is provided, whichever is earlier. A credit union is deemed to have provided a service when a fee required to be disclosed is assessed. When an account is opened and the member or consumer is not present (and the member has not received the disclosures), a credit union must mail or deliver the account opening disclosures no later than 10 business days after the account is opened or the service is provided, whichever is earlier.

However, if a member or consumer who is not present at the institution uses electronic means to apply to open an account or to request a service, the disclosures must be provided before the account is opened or the service is provided.

Request for Disclosures. Section 707.4(a)(2) requires a credit union to provide full account disclosures, including applicable fees, to a member or consumer upon request – even if the consumer is not a member. A response to an oral inquiry (by telephone or in person) about rates and yields or fees does not trigger the duty to provide account disclosures. However, when consumers or members ask for written information about an account, the credit union must provide the disclosures, unless the account is no longer offered to the public.

If the consumer or member makes the request in person, disclosures must be provided at that time. If a consumer is not present when the request is made, the credit union must mail or deliver the disclosures within a reasonable time after it receives the request. Ten business days is considered a "reasonable time" by NCUA. For those requests not made in person, the disclosures can be mailed in paper form, or if the member agrees, they can be delivered electronically to an email address provided for that purpose without regard to consent or other provisions of the E-SIGN Act.

SUBSEQUENT DISCLOSURES

Section 707.5 requires disclosures when the terms of an account change, resulting in a negative effect on the member. In addition, this section covers the required disclosures for both term share accounts that automatically renew and have a maturity longer than one month, and term share accounts that do not renew automatically and have a maturity of longer than one year.

Change in Terms

A credit union must give advance notice of any change in a term that is required to be disclosed at account opening if the change may reduce the annual percentage yield or adversely affect the consumer. The notice must include the effective date of the change and must be mailed or delivered at least 30 calendar days before the changes take effect.

The staff commentary notes several ways that credit unions can provide the change in terms notices, such as on or with a regular periodic statement or in another mailing such as a highlighted portion of a newsletter or statement stuffer insert.

NAFCU NOTE

As explained in this Compliance Blog post, the Truth in Savings Act regulations do not require notice when the change in terms is beneficial to the member

However, a credit union is not required to provide a notice in certain situations. Those include:

- For variable-rate accounts, any change in the dividend rate and corresponding changes in the annual percentage yield;
- Any changes in fees assessed for check printing;
- Changes that take effect upon the occurrence of an event, if it was previously disclosed; or
- Changes in any term for term share accounts with maturities of one month or less.

Maturity Notices for Term Share Accounts

For automatically renewing share certificate accounts with maturity longer than one month, a credit union must provide disclosures prior to maturity of the account. There are different requirements for term share accounts that renew automatically that have maturities of longer than one year, and term share accounts with maturities longer than one month but less than one year. For the purposes of this section, it is enough to understand that the longer the maturity, the more information must be provided in the disclosures. For additional details, review section 707.5(b).

For term share accounts that do not renew automatically, a credit union must provide the member with a notice informing the member of the maturity date of the account and whether dividends will be paid after maturity. This notice must be mailed or delivered at least 10 calendar days before maturity of the existing account.

NAFCU NOTE

For a clearer understanding of the various timing and content requirements for Share Certificate maturity notices, consult the helpful chart in this NAFCU *Compliance Blog* post.

PERIODIC STATEMENT DISCLOSURES

NCUA's Truth in Savings regulation does not require credit unions to provide periodic statements (though Regulation E may require a statement). However, for credit unions that mail or deliver periodic statements, section 707.6 sets forth specific information that must be included.

Section 707.2 defines a periodic statement as a statement setting forth information about an account that is provided on a regular basis four or more times a year. The definition of periodic statement excludes term share accounts and passbook accounts. Those types of accounts are not subject to the requirements surrounding periodic statements. In other words, the credit union has the flexibility to decide whether to follow the requirements of section 707.6 or not for these types of accounts.

Content of Periodic Statements

If a credit union sends periodic statements, the statement must include:

- **Annual Percentage Yield Earned.** A credit union must state the annual percentage yield earned during the statement period, using that term, and calculated according to Appendix A of NCUA's Truth in Savings regulation.
- **Amount of Dividends.** A credit union must state the dollar amount of dividends earned during the statement period, whether or not dividends were credited.
- **Fees Imposed.** A credit union must report any fees that are required to be disclosed and that were debited to the account during the statement period, even if assessed for an earlier period. The fees must be itemized by type and dollar amounts. When fees of the same type are imposed more than once in a statement period, a credit union may: 1) itemize each fee separately; or 2) group the fees together and disclose a total dollar amount for all fees of that type.
- **Length of Period.** A credit union must indicate the total number of days in the statement period, or the beginning and ending dates of the period.
- **Aggregate Fee Disclosure.** Credit unions must provide totals for fees for the payment of overdrafts and for returned items unpaid, both for the statement period and for the calendar year to date. These fees must be disclosed using a format substantially similar to Model Form B-12 in Appendix B of NCUA's Truth in Savings regulation.

ADVERTISING

It is important to advertise a credit union's accounts and to promote its services. However, when doing so, advertisements must comply with Truth in Savings requirements. Section 707.8 contains account advertising requirements, including general rules and rules for special account features. In addition, the section describes advertising involving certain types of media and in-house posters that are exempt from the advertising requirements. The advertising requirements are examined in more detail below, including the interrelation of the advertising rules with other requirements of Truth in Savings.

RESEARCH TIP: This Federal Reserve *Consumer Compliance Outlook* article provides useful analysis of many of the advertising rules. Reviewing this type of secondary source may provide helpful guidance to credit unions, since the CFPB's Regulation DD is nearly identical to NCUA's rule; however, it is important to also review NCUA's regulation when researching Truth in Savings rules.

Scope

Before getting into the details of the advertising requirements, it is useful to remember that the definitions of terms can have an impact on the scope of the requirements of Truth in Savings. Therefore, the first important question to ask: "Is this an advertisement?"

An advertisement is defined by section 707.2 as a commercial message that appears in any medium and that promotes directly or indirectly the availability of, or a deposit in, a share account.

This is a very broad definition; however, the staff commentary notes that the following are not advertisements:

- Rate sheets published in newspapers, periodicals or trade journals, unless the credit union pays a fee to have the information included or otherwise controls the publication.
- In-person discussions initiated by a member or potential member.
- In-person discussions with a member about the terms for a specific account.

When the credit union has an advertisement, the next step is to ensure that it is compliant.

Misleading or Inaccurate Advertising

A credit union may not advertise in a way that is misleading or inaccurate or misrepresents its account contract. This general prohibition is contained in section 707.8(a) and section 740.2 of NCUA's regulations. The staff commentary to section 707.8(a) provides the following examples of advertisements that are considered misleading, inaccurate or misrepresent the account contract:

- Representing an overdraft service as a "line of credit," unless it is subject to Regulation Z;
- Representing that the institution will honor all checks or authorize all transactions that overdraw an account, when the institution retains discretion not to honor checks or authorize transactions;

- Representing that consumers who overdraw an account are allowed to maintain a negative balance when account terms require consumers promptly to return the account to a positive balance;
- Describing an institution's overdraft service only as protection against bounced checks when the institution also permits overdrafts for a fee when accounts are overdrawn by other means; and
- Advertising an account-related service for which the institution charges a fee in an advertisement that also uses the word "free" or "no cost" (or a similar term) to describe the account, unless the advertisement clearly indicates that there is a cost associated with the service. If the fee is a maintenance or activity fee, however, an advertisement may not describe the account as "free" or "no cost" (or contain a similar term) even if the fee is disclosed in the advertisement.

NAFCU NOTE

For more information on advertising "free" accounts, have a look at this NAFCU *Compliance Blog* post. NAFCU's *Credit Union Compliance Advertising Guide* (member-only) also provides more details on all the advertising rules.

Advertising "Free" or "No Cost" Accounts

As noted above, a credit union's advertisement may not refer to or describe an account as "free" or "no cost" (or contain a similar term such as "fees waived") if a maintenance or activity fee may be imposed on the account. The staff commentary provides examples of maintenance or activity fees:

- Fees imposed when a minimum-balance requirement is not met or when consumers exceed a specified number of transactions;
- Transaction and service fees that consumers reasonably expect to be imposed on a regular basis, as discussed in comments 707.4(b)(4)-1 and -2;
- A flat fee, such as a monthly service fee; and
- Fees for the deposit, withdrawal or transfer of funds, including per-check or per-transaction fees (for example, $.25 for each withdrawal, whether by check or in person).

The staff commentary also provides examples of fees that are not maintenance or activity fees:

- Fees not required to be disclosed under section 707.4(b)(4) (initial account disclosures);
- Check-printing fees;
- Fees for obtaining copies of checks, whether or not the original checks have been truncated or returned;

- Balance-inquiry fees;
- Stop-payment fees and fees associated with checks returned unpaid;
- Fees assessed against a dormant account; and
- Fees for using an ATM or electronic transfer services (such as preauthorized transfers or home banking services) not required to obtain an account.

Remember, it is not prohibited to charge maintenance or activity fees. What is prohibited is to call the account "free" if these sorts of fees are charged. Certain fees, such as minimum balance fees, clearly cannot be charged on free accounts; and fees such as ATM fees, clearly can be charged. However, there are many other fees that may be charged on a checking account that do not clearly fall in the categories provided in the commentary. The examples from the staff commentary to section 707.4(b)(4), the rule requiring the disclosure of certain fees at account opening, can also be useful in determining whether a charge is considered a "maintenance or activity fee."

MORE INFORMATION: The CFPB has taken action against some banks for charging fees on accounts marketed as "free" under its supervisory and enforcement authority utilizing UDAAP. While most credit unions are not subject to the CFPB's supervisory and enforcement authority, this is worth considering in the context of advertising accounts as free, since both NCUA and state attorneys general also have enforcement authority for UDAAPs.

Advertising Rate Information

Under section 707.8(b), when a credit union states a rate of return in an advertisement, it must state the rate as an "annual percentage yield," using that term. If the advertisement uses the abbreviation "APY," the term "annual percentage yield" must be stated at least once in the advertisement.

If the advertisement uses the term "dividend rate," it must use the term with, but not more conspicuously than, the related annual percentage yield. It must round the annual percentage yield, the annual percentage yield earned, and the dividend rate to the nearest one-hundredth of one percentage point (.01 percent) and express them to two decimal places.

Trigger Terms and Additional Disclosures

When an advertisement includes an annual percentage yield, this may "trigger" certain additional disclosures, as appropriate. Keep in mind that these requirements do not apply for certain media under an exemption discussed later in this section. Section 707.8(c) explains the following items may need to be disclosed when an advertisement contains an annual percentage yield:

- **Variable Rates.** For variable-rate accounts, the advertisement must state that the rate may change after the account is opened.
- **Time Annual Percentage Yield is Offered.** The advertisement must include the period of time during which the annual percentage yield will be offered. Alternatively, the advertisement may state that the annual percentage yield is accurate as of a specified date.
- **Minimum Balance.** For accounts that have a required minimum balance, the advertisement must state the minimum balance required to obtain the advertised annual percentage yield.
- **Minimum Opening Deposit.** For an account that requires a minimum deposit to open the account, the advertisement must state the minimum deposit required to open the account, if it is greater than the minimum balance necessary to obtain the advertised annual percentage yield.
- **Effect of Fees.** An advertisement must state that fees could reduce the earnings on the account. This requirement only applies to maintenance or activity fees.
- **Features of Share Certificate Accounts.** For share certificate accounts, the advertisement must include:
  - Term of the account;
  - Early withdrawal penalties — a statement that a penalty will or may be imposed for early withdrawal; and
  - Required dividend payouts — a statement that dividends cannot remain on deposit and that payout of dividends is mandatory for noncompounding time accounts with certain features outlined in the regulation.

The staff commentary notes that if an electronic advertisement (such as an advertisement appearing on an Internet website) displays a triggering term (such as a bonus or annual percentage yield), the advertisement must clearly refer the consumer to the location where the additional required information begins. For example, an advertisement that includes a bonus or annual percentage yield may be accompanied by a link that directly takes the consumer to the additional information.

NAFCU NOTE

For more information on Truth in Savings Act advertising requirements, including a discussion of when trigger terms won't apply for certain advertising media, read this post in the Compliance Blog.

Advertising Bonuses

If a credit union states a "bonus" in an advertisement, the advertisement must state the following, if applicable to the advertised product:

- "Annual percentage yield," using that term;
- Time requirements to obtain the bonus;
- Minimum balance required to obtain the bonus;
- Minimum balance required to open the account, if it is greater than the minimum balance necessary to obtain the bonus; and
- When the bonus will be provided.

However, these requirements do not necessarily apply if the situation falls under the exemption for certain advertisements discussed below. In addition, general statements such as "bonus checking" or "receive a bonus when you open a checking account" do not trigger the bonus disclosures.

NAFCU NOTE

This NAFCU *Compliance Blog* post explains what types of a payments are considered bonuses.

Advertising the Payment of Overdrafts

A credit union that promotes the payment of overdrafts in an advertisement must also include in the advertisement the disclosures required under section 707.11(b). These requirements are discussed in detail later in this section.

Exemption for Certain Advertisements

Section 707.8(e) exempts certain types of media and certain indoor signs from some of the regulation's advertising rules.

Media Exemptions

The following types of media are exempt from the advertising rules:

- Broadcast or electronic media, such as television or radio. However, the exemption does not extend to Internet and e-mail advertisements;
- Outdoor media, such as billboards; or
- Telephone response machines. However, solicitations for a tiered-rate account made through telephone-response machines must provide the annual percentage yields and the balance requirements applicable to each tier.

When any of these media are used, the advertisement is exempt from the following requirements:

- Trigger term disclosures, such as variable rates, time an annual percentage yield is offered, minimum opening deposit, effect of fees and early withdrawal penalties for time accounts; and
- Additional disclosures for bonuses, such as information related to a minimum balance to open an account (if it is greater than the minimum balance necessary to obtain the bonus) and when the bonus will be provided.

Indoor Signs

If a credit union posts account information on signs inside its premises, the postings are exempt from the advertising requirements for:

- Permissible rates (the requirements of section 707.8(b));
- Trigger term disclosures (the requirements of section 707.8(c)); and
- Bonuses (the requirements of section 707.8(d)).

If a sign, falling under this exemption, states a rate of return, it must:

- State the rate as an "annual percentage yield," using that either term or "APY." The sign must not state any other rate, although the related dividend rate may be stated; and
- Contain a statement advising consumers to contact an employee for further information about applicable fees and terms.

Indoor signs include advertisements displayed on computer screens, banners, preprinted posters and chalk or peg boards. Any advertisement inside the premises that can be retained by a consumer (such as a brochure or a printout from a computer) is not an indoor sign.

OVERDRAFT PROTECTION PROGRAMS

Both Congress and regulators have voiced concerns about overdraft protection programs. These programs sometimes referred to as "bounced-check protection" or "courtesy pay," involve paying member checks, and possibly allowing other overdrafts, when there are insufficient funds in the account. Given their concerns, NCUA amended the Truth in Savings regulation to include requirements specific to overdraft protection programs. The requirements address concerns about the uniformity and adequacy of information provided to consumers when they overdraw their accounts.

RESEARCH TIP: NCUA's Interagency Guidance on Overdraft Protection Programs provides information about safety and soundness concerns, risks and best practices related to an overdraft service.

Periodic Statement Disclosures

Disclosure of Total Fees

Unless covered by an exception, if an institution has an overdraft protection program, section 707.11(a) requires credit unions to disclose on its periodic statements separate totals for the statement period and for the calendar year to date for:

- The total dollar amount for all fees imposed on the account for paying checks or other items when there are insufficient funds and the account becomes overdrawn, using the term "Total Overdraft Fees," and
- The total dollar amount for all fees imposed on the account for returning items unpaid.

The total dollar amount for paying overdrafts includes per-item fees, daily or other periodic fees and fees charged for maintaining an account in overdraft status. It also includes fees charged when there are insufficient funds because previously deposited funds are subject to a hold or are uncollected.

The overdraft fee disclosure requirements do not apply to fees for transferring funds from another account to avoid an overdraft or fees charged when the institution has previously agreed in writing to pay items that overdraw the account and the service is subject to Regulation Z.

Advertising Disclosures for Overdraft Services

Under section 707.11(b), any advertisement promoting the payment of overdrafts must disclose all of the following:

- The fee(s) for the payment of each overdraft;
- The categories of transactions for which a fee may be imposed for paying an overdraft;
- The time period by which the member must repay or cover any overdraft; and

- The circumstances under which the credit union will not pay an overdraft.

However, exceptions do apply. The advertising disclosure rules for overdraft services do not apply in the following circumstances:

- An advertisement promoting a service where the credit union's payment of overdrafts would be agreed upon in writing and subject to Regulation Z;
- A communication by an institution about the payment of overdrafts in response to a member-initiated inquiry about deposit accounts or overdrafts. However, providing information about the payment of overdrafts in response to a balance inquiry made through an automated system, such as a telephone response machine, ATM or a credit union's Internet site, is not a response to a consumer-initiated inquiry;
- An advertisement made on outdoor media, such as billboards;
- An ATM screen or ATM receipt; and
- An in-person discussion with a member or consumer.

Keep in mind that this is an abbreviated list and other exceptions do apply. Please see section 707.11(b)(2-4) for the full list of exceptions.

NAFCU NOTE

Litigation involving overdraft protection programs has increased in recent years. This Compliance Blog post discusses litigation trends, including lawsuits over overdraft of insufficient funds fees. Additionally, the CFPB declared earlier this year that certain overdraft practices could amount to a UDAAP violation, as explained in this post.

Disclosure of Account Balances

Under section 707.11(c), account balances disclosed through an automated system such as an ATM, website or automated phone service must include only the amount immediately available for withdrawal. Specifically, the account balance cannot include additional funds that the credit union may provide as an overdraft service or other funds that may be transferred from another account. NCUA recognized in the staff commentary that this could be problematic for sweep accounts because of the unique aspects of those accounts and clarified that for retail sweep programs, the credit union may disclose the total balance available in both subaccounts.

Credit unions are permitted to disclose an additional balance including overdraft funds so long as it is clear that the balance includes additional overdraft funds or in instances where additional funds are only available for certain transactions. The staff commentary explains how such disclosures should be made and references the Regulation E rule, which requires members to opt-in to overdraft protection for ATM and one-time debit card transactions before fees can be charged.

PAYMENT OF DIVIDENDS

Section 707.7 requires a credit union to calculate dividends on the full amount of principal in an account for each day by using either: 1) the daily balance method, which applies the daily periodic rate to the full amount of principal in the account each day; or 2) the average daily balance method, which applies a periodic rate to the average daily balance in the account for the period. For example, the staff commentary notes that credit unions may apply a daily periodic rate greater than 1/365 of the dividend rate – such as 1/360 of the dividend rate – as long as it is applied 365 days a year.

Truth in Savings does not require a credit union to compound or credit dividends at any particular frequency. Credit unions choosing to compound dividends may compound or credit dividends annually, semi-annually, quarterly, monthly, daily, continuously or on any other basis. A credit union may choose not to pay accrued dividends if members close their account prior to the date accrued dividends are credited, as long as the credit union has disclosed this practice in the initial account disclosures.

However, the regulation requires that dividends must begin to accrue no later than the business day specified for dividend-bearing accounts in the Expedited Funds Availability Act, which requires dividends to begin accruing in dividend-bearing accounts no later than the business day on which an institution provides provisional credit for such funds.

This is a good time for a reminder that credit unions pay dividends, **not interest**. Take a look back at the part on the use of synonyms at the beginning of this section for a refresher on the difference between the two.

RECORD RETENTION

Timing. Under section 707.9(c), credit unions must retain records that can show compliance with Truth in Savings for a minimum of two years after the date that disclosures are required to be made or an action is required to be taken.

Evidence of Required Actions. A credit union may demonstrate its compliance by:

- Establishing and maintaining procedures for paying dividends and providing timely disclosures; or
- Retaining sample disclosures for each type of account offered to members such as account-opening disclosures, copies of advertisements and change-in-term notices, as well as information regarding the dividend rates and annual percentage yields offered.

Methods of Retaining Evidence. Note that a credit union must be able to reconstruct the required disclosures and other required actions but does not need to maintain hard copies of disclosures and other records. It may keep records evidencing compliance in microfilm, microfiche or other methods that reproduce records accurately (including computer files).

CHAPTER 2 — MEMBER ACCOUNTS

SECTION 5 — E-SIGN ACT

OVERVIEW

This section will provide an overview of the Electronic Signatures in Global and National Commerce Act (E-SIGN Act) and how it relates to credit union operations. The E-SIGN Act affects credit unions in three main areas: legality of electronic signatures, contracts, and other records; record retention and electronic delivery of required disclosures.

A LAW WITHOUT REGULATIONS

One of the most confusing aspects about the E-SIGN Act is the lack of implementing regulations. Credit unions must follow the plain language of the E-SIGN Act, and any guidance regarding it included in other regulations.

MORE INFORMATION: Because of the lack of implementing regulations, judicial interpretations of the E-SIGN Act and its requirements can help credit unions understand how case law can shape what is necessary to comply with the E-SIGN Act. Outside counsel can help credit unions recognize and understand the relevant case law that exists if an issue is unclear.

Be careful not to fall into the “this is how other institutions do it” trap. The E-SIGN Act is complicated and widely misunderstood. Relying solely on another bank or credit union’s process may not always lead to adequate processes.

LEGALITY OF ELECTRONIC RECORDS

The E-SIGN Act establishes that electronic signatures, contracts, and other records are valid and enforceable if they meet certain criteria. In other words, the E-SIGN Act allows electronic signatures and documents to carry the same legal weight as wet-ink signatures and paper documents under federal law. This fact is important in both online agreements and record retention, as the E-SIGN Act allows credit unions to adopt online applications where the member provides an electronic signature to agree to membership or a loan.

NAFCU NOTE

This NAFCU *Compliance Blog* post takes a look at using e-signatures for online accounts and applications.

There are, however, certain situations where the E-SIGN Act does not apply. For example, it does not apply to matters involving family law, probate and the creation of wills, court orders, certain portions of the Uniform Commercial Code or notices regarding repossessions and foreclosures. A full list of what is outside the scope of the law can be found in section 103 of the E-SIGN Act. Further, it may be preempted by similar state laws, for example, a state's adopted version of the Uniform Electronic Transactions Act (UETA).

ELECTRONIC RECORD RETENTION

The E-SIGN Act allows records retained in electronic form to meet record retention requirements. For the electronic records to be acceptable, the records must accurately reflect the information in the original document, must be accessible and must be capable of being accurately reproduced. NCUA has indicated in legal opinion letters that electronic record retention is an acceptable practice for credit unions. In general, record retention requirements can be satisfied with either an electronic image of an original hard copy or an electronic record of the information itself (such as information originated electronically). While the E-SIGN Act may allow credit unions to retain records electronically, other business reasons may exist for the credit union to retain original records.

ELECTRONIC DISCLOSURES

With pressure on credit union budgets from multiple fronts, credit unions are looking for ways to reduce costs while retaining the same level of member service. One avenue that credit unions continue to explore is electronic disclosures and statements under the E-SIGN Act. Credit unions looking to expand their membership's participation in electronic disclosures, thereby reducing paper and mailing costs, need to ensure their members have properly consented to receiving electronic disclosures pursuant to E-SIGN Act requirements.

Opt-in Requirement; Not Opt-out

The E-SIGN Act requires an "opt-in" system for electronic delivery where the member has affirmatively consented to receiving the required disclosures in electronic form. In other words, the credit union cannot place every member on electronic disclosures and process "opt-outs" from members who would prefer to continue receiving paper disclosures and statements. However, this requirement would not prevent the credit union from offering a "paperless" account with better terms available only to members who agree to those terms – including electronic disclosures and online banking. Similarly, credit unions can offer incentives (such as bonuses, waived fees, higher yields or lower rates) to encourage members to "opt in" to electronic disclosures.

Electronic Consent or Confirmation Required

In addition to the "opt-in" requirement, the member's affirmative consent to electronic disclosures must be made electronically or confirmed electronically. The requirement comes from section 101(c)(1)(C)(ii):

> *"(C) the consumer— ...(ii) consents electronically, or confirms his or her consent electronically, in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent."*

Therefore, if a member informs a teller they want to opt in to electronic disclosures and the credit union provides the required E-SIGN disclosures – the member would still need to confirm his or her consent electronically using the member's own equipment.

MORE INFORMATION: This Federal Reserve *Consumer Compliance Outlook* article provides more details on the consumer consent process for electronic disclosures.

One potential solution is to have a dedicated webpage, which could be inside the credit union's online banking product, to process electronic consents from members, which provides the mandatory E-SIGN disclosures and captures the member's consent electronically.

Reasonably Demonstrate Ability to Access Electronic Information

The requirement for the consent or confirmation to "reasonably demonstrate" the member's ability to access the information electronically presents an additional hurdle. While most members can retrieve PDF or other electronic documents, the credit union must still ensure the member can receive the disclosures electronically. Some financial institutions use "sample statements" during the E-SIGN consent or confirmation process which members need to open and retrieve a code or dollar amount (such as an ending statement balance) to enter before completing the E-SIGN consent. This process, known commonly as the "test drive," can be used as evidence the member was able to open and read the statement – thereby "reasonably demonstrating" the ability to access electronic information. Once a credit union has properly obtained consent to send electronic disclosures, it is not expressly required by statute to monitor whether members actually open and read them each time a disclosure is sent electronically.

Hardware and Software Requirement Disclosure

Prior to a member consenting for electronic disclosures, the credit union must provide a statement of the hardware and software requirements to access and retain electronic disclosures. If, after the member's consent, the credit union changes the hardware or software requirements – and that change creates a material risk the member may not be able to access and retain the electronic disclosures going forward – the credit union will need to obtain a new electronic consent from the member. Unfortunately, there is no guidance available to credit unions on which changes "create a material risk" that members will not be able to access the electronic disclosures. The credit union will need to analyze the hardware and software requirements originally disclosed to the member and make a determination on whether the subsequent changes are likely to prevent a member from being able to access and retain the disclosures.

Breadth and Scope of E-SIGN Consent

When developing or amending E-SIGN Act procedures, credit unions will want to clarify which disclosures they wish to provide electronically. Credit unions should look at the disclosures that are currently sent to members (e.g., periodic statements, change-in-terms notices, privacy policy, adverse action notices, certificate maturity notices, etc.) and decide whether the credit union wants to include these disclosures in the scope of records members are providing their affirmative consent to receive electronically. Section 101(c)(1)(B)(ii) of the E-SIGN Act requires a description of the records which will be provided electronically:

> *"(ii) informing the consumer of whether the consent applies (I) only to the particular transaction which gave rise to the obligation to provide the record, or (II) to identified categories of records that may be provided or made available during the course of the parties' relationship."*

NAFCU NOTE

Not all disclosures require consent before they can be delivered electronically. Check out this NAFCU *Compliance Blog* post for more information.

Thus, the credit union has latitude to include additional records beyond periodic statements in the member's electronic consent so long as it properly discloses the categories of records which will be sent electronically. Because of the difficulty in obtaining electronic consent from members, the credit union should be sure to identify which disclosures it wants to provide electronically and be sure those are included in the E-SIGN disclosure.

Note that some disclosures can be provided electronically without completing the full E-SIGN Act consent requirements. For example, section 1026.41(c) of Regulation Z allows periodic statements for mortgage loans to be sent electronically where the member provides affirmative consent (as clarified by comment 3 in the staff commentary). However, the rule does not require the credit union to obtain full E-SIGN consent, as discussed in the preamble to the final rule. By contrast, Regulation B's rule on providing appraisals specifically states that electronic disclosures must comply with the E-SIGN Act. When in doubt as to whether you need to obtain full E-SIGN consent, check the regulation and the associated commentary; it should indicate which disclosures require the full E-SIGN Act consent requirements.

Potential Consequences of Improper E-SIGN Consent

If a credit union does not follow the E-SIGN Act requirements, ultimately, a court could determine the disclosures were never properly delivered to the member. For example, Regulation E's error resolution procedures rely on the timing of a periodic statement. If that statement was sent electronically, without proper E-SIGN Act consent, the "clock" for the member's claims of unauthorized transactions might not begin as the periodic statement was not properly delivered. Alternatively, a member could attempt to challenge the credit union's "change-in-terms" for his or her credit card account if the credit union sent the notice electronically and the member had not electronically consented — arguing the change is null and void for that member. Section 101(c)(3) of the E-SIGN Act does indicate the failure to obtain proper consent would not prevent a contract from being valid and enforceable. However, this does not give credit unions a "get out of jail free" card. The account may be valid, but the lack of proper disclosures could be in violation of the relevant regulation (Regulation E, Regulation Z, Truth in Savings, etc.).

NAFCU NOTE

This NAFCU *Compliance Monitor* article provides an explanation of the E-SIGN Act's requirements and answers a few frequently asked questions.

Handling Invalid Email Addresses

As electronic disclosures have increased in frequency, so have instances where disclosures are returned due to invalid or bad email addresses. Previous interim final rules (later retracted by the agencies) provided guidance on these situations indicating institutions should attempt to send the disclosures to another email address, if they had one, or return to paper disclosures until obtaining a working email address. Those interim final rules are no longer valid, but they do provide credit unions with some potential options. Some credit unions have added an intermediary page — after log-in to online banking and before access to the member's accounts — that requires the member to confirm their email address. This process could be set up for periodic confirmation of email addresses or limited to members whose email addresses have resulted in undeliverable disclosures.

For privacy and security of member information, the credit union may want to directly contact and confirm the email or mailing address to ensure the member is the one receiving the disclosures and not a potential fraudster (most credit union bylaws contain a requirement for members to update their address with the credit union). If the credit union is unable to obtain a working email address, it may want to follow the prior guidance and switch the member back to paper disclosures.

CHAPTER 3

Lending

CHAPTER 3 — LENDING

SECTION 1 — NCUA LENDING REQUIREMENTS

OVERVIEW

When legislators drafted the Federal Credit Union Act (FCU Act), they created numerous powers and limitations that impact credit union operations. It should come as no surprise that the drafters of the FCU Act spent a good deal of time on lending issues. While the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) tend to steal the headlines, NCUA implemented the FCU Act's lending components in regulations that create foundational requirements and limitations concerning federal credit union lending activities.

This section addresses the major components of NCUA's lending rule found in section 701.21, the loan participation rule found in section 701.22 and the commercial and member business lending rules found in Part 723. The section is not designed to address every facet and nuance of credit union lending. Nothing can replace thorough research as the ultimate way to understand a particular issue.

MORE INFORMATION: **Beyond federal requirements, credit unions must also follow many state law requirements regarding lending, though NCUA's rules preempt many state law rules regarding lending for federal credit unions. More information on NCUA's preemption of state laws can be found in Chapter 1, Section 6.**

MEMBERSHIP NEXUS

Generally, federal credit unions can loan money only to their members. NCUA has consistently indicated that federal credit unions may serve nonmembers in the lending context "as long as their involvement does not distort the relationship between the federal credit union and the member." Nonmembers, for example, can be a cosigner or guarantor on member loans. In addition, a nonmember can be an authorized user on a member's credit card. Nonmembers, however, cannot be co-applicants, co-makers or co-borrowers who would be a recipient of loan proceeds.

MATURITY LIMITS

The FCU Act, as implemented by NCUA's regulations, places limits on the length of loans credit unions can offer (referred to as maturity limits). The general maturity limit and the exceptions are all found in subsections 701.21(c)(4),(f) and (g).

Fifteen Years

The general maturity limit for federal credit unions is 15 years. If one thinks of the different maturity limits as buckets, then a credit union could place every loan it makes into this 15-year bucket.

EXAMPLE

Federal credit unions can make car loans, boat loans, home loans and home equity loans with 15-year maturities.

Twenty Years

In limited cases, federal credit unions can offer maturities up to 20 years. Federal credit unions may do so in the following situations:

- For a loan to finance the purchase of a mobile home if the mobile home will be used as the member-borrower's residence, the loan is secured by a first lien on the mobile home and the mobile home meets the requirements for the home mortgage interest deduction under the Internal Revenue Code.
- For a second mortgage loan (or a nonpurchase money first mortgage loan in the case of a residence on which there is no existing first mortgage) if the loan is secured by a residential dwelling which is the residence of the member-borrower.
- For a loan to finance the repair, alteration or improvement of a residential dwelling which is the residence of the member-borrower.

Therefore, to extend the bucket analogy, this 20-year bucket is permissible to use under certain circumstances. Fewer loans, however, can be placed into this bucket. If the loan does not meet one of the three types above, it cannot qualify for this maturity length.

Up to Forty Years

There is another bucket of maturities for federal credit unions, but the bucket holds a very specific type of loan – residential real estate loans with certain characteristics. A federal credit union may make residential real estate loans to members, including loans secured by manufactured homes permanently affixed to the land, with maturities of up to 40 years (or longer period as may be permitted by the NCUA Board on a case-by-case basis). To qualify for this maturity, the loans must meet the criteria in the rule, some of which is outlined below.

Statutory Limits. The loan must be made on a one- to four-family dwelling that is or will be the principal residence of the member-borrower. In addition, the loan must be secured by a perfected first lien in favor of the credit union on the dwelling (or a perfected first priority security interest in the case of either a residential cooperative or a leasehold or ground rent estate).

MORE INFORMATION: NCUA Legal Opinion Letter 10-0729 interprets the "is or will be the principal residence of the member" requirement.

The Loan Application Form, Security Instrument and Note. The loan application, security instrument and note shall be on standard Federal Housing Administration, Veterans Administration or Federal Home Loan Mortgage Corporation/Federal National Mortgage Association (Fannie Mae/Freddie Mac) forms. In place of these standard forms, a federal credit union may have a current attorney's opinion on file stating that the forms in use meet the requirements of applicable federal, state and local laws.

Lien and Territory Issues. The loan must be secured by a perfected first lien or first priority security interest in favor of the credit union supported by a properly executed and recorded security instrument. The loan may not be secured by a residence located outside the United States of America, its territories and possessions or the Commonwealth of Puerto Rico.

Lines of Credit

Lines of credit, including HELOCs, credit cards and overdraft lines of credit are not subject to any maturity limitation.

Other Issues Related to Maturity

Payday Alternative Loans (PALs)

NCUA does allow federal credit unions to issue special payday alternative loans (PALs). There are two types of PALs and each type has specific restrictions which are discussed later in this section. One of these restrictions is related to maturity. PALs I loans may have maturities between one and six months. PALs II loans may have maturities between one and twelve months.

Balloon Loans

Credit unions looking at NCUA's maturity limitations may consider the use of balloon payments. With a balloon payment, a credit union can issue a loan with a 15-year maturity that has a large balloon payment at the end. NCUA has stated that balloon payment loans are generally permissible, if the balloon payment loan is not being used to circumvent NCUA's maturity restrictions in the FCU Act and NCUA's regulations. In Legal Opinion Letter 96-0753, NCUA indicated that extending subsequent loans to refinance balloon payments are also permissible as long as the series of transactions reflects no intent to circumvent the loan maturity restrictions.

NAFCU NOTE

For a comparison of the various maturity limits and related frequently asked questions, check out this NAFCU *Compliance Monitor* article (member-only).

THE USURY CEILING

Under the FCU Act, federal credit unions are subject to a 15 percent interest rate ceiling unless the NCUA Board establishes a higher rate after considering certain statutory criteria. The NCUA Board is required to reconsider its determination no less frequently than every 18 months. While the regulatory text of section 701.21(c)(7)(i) lists the usury rate as 15 percent as stated in the Act, the NCUA Board regularly sets the rate higher. The NCUA Board determined at its January 2023 meeting to extend the 18 percent interest rate cap through September 10, 2024.

Inclusive of Finance Charges.

The FCU Act clearly indicates that the usury ceiling is inclusive of finance charges:

> ***"(vi) the rate of interest may not exceed 15 per centum per annum on the unpaid balance inclusive of all finance charges, except that the Board may establish – (I) after consultation with the appropriate committees of the Congress, the Department of Treasury, and the Federal financial institution regulatory agencies, an interest rate ceiling exceeding such 15 per centum per annum rate, for periods not to exceed 18 months, if it determines that money market interest rates have risen over the preceding six-month period and that prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth[.]"***

When evaluating whether a particular fee or charge is a finance charge or not, NCUA opined in Legal Opinion Letter 91-0412 that it has traditionally looked to the federal regulator with authority over the TILA (and Regulation Z):

> ***"Neither the [Federal Credit Union] Act nor the [NCUA] Regulations defines the term "finance charge." Our longstanding practice has been to give "finance charge" the definition set forth in the Federal Reserve Board's Regulation Z, 12 C.F.R. Part 226. Section 226.4(c) of Regulation Z states, in part, "The following charges are not finance charges:...(2) charges for actual unanticipated late payment...." As you know, Regulation Z is a disclosure regulation. Generally, it does not control the interest rate or other charges in a loan agreement; it merely imposes requirements for disclosure of those charges. While credit unions are bound by Regulation Z's definition of finance charge for disclosure purposes, NCUA alone has authority to determine which types of charges are included in the computation of interest for the usury ceiling set forth in the Act and Regulations. We do, however, generally look to Regulation Z for guidance on the issue of what constitutes interest, and we have consistently followed the definition of finance charge set forth in Regulation Z. It is therefore our position that late charges are not finance charges, and need not be taken into account in calculating the interest rate for purposes of the usury provisions of the Act and Regulations."***

Regulation Z is now under the purview of the Consumer Financial Protection Bureau (CFPB), and is located at 12 C.F.R. Part 1026. Thus, while NCUA retains the authority to determine which fees and charges are finance charges for usury ceiling purposes, it has historically followed the definition of finance charge in Regulation Z.

PALs Exception

Credit unions may charge interest at a rate of up to 1,000 basis points above the current usury ceiling for loans that qualify as a PALs I or II loan under subsections 701.21(c)(7)(iii)-(iv). As the usury rate is currently 18 percent, this means credit unions may charge 28 percent interest for PALs.

Note that federal credit unions are not required to offer PALs I or II loans. Credit unions may continue to offer closed or open-end payday alternative loan programs of their own that operate successfully and legally under NCUA's regulations and the Consumer Financial Protection Bureau's (CFPB's) Regulation Z. However, those loans would still be subject to the usury ceiling of 18 percent.

In order to operate a PAL program, a credit union must update its lending policy to reflect the PAL program and include a limit on the aggregate dollar amount of loans it will extend. This amount cannot exceed 20 percent of the credit union's net worth. The credit union's lending policy must include appropriate underwriting guidelines to minimize risk to the credit union.

Both PALs I and PALs II loans must be closed-end loans that are fully amortized over the life of the loan. The credit union may not make more than one PAL to a member at a time and no more than three PALs to a member within any six-month rolling period. Further, the credit union may not roll-over a PAL, unless the extension does not result in any additional fees or involve an extension of additional credit. The credit union's PAL application fee may not exceed the cost associated with processing the application and it may not exceed $20.

Each PAL type also has its own requirements regarding principal balance, term and more. The main differences between PALs I and PALs II loans are described in the comparison chart below:

PALs I Requirements	PALs II Requirements
Minimum principal amount of $200. Maximum principal amount of $1,000.	No minimum principal amount. Maximum principal amount of $2,000.
Minimum term of one month, and maximum term of six months.	Minimum term of one month, and maximum terms of twelve months.
Borrower must be a member of the credit union for at least one month.	Member is immediately eligible – no waiting period.
No prohibition on overdraft/NSF fees.	Overdraft/NSF fee for overdraft service as defined in Regulation E cannot be assessed.

Monitoring for Compliance with the Usury Ceiling

NCUA has published little guidance about how it expects federal credit unions to comply with the usury ceiling limitation. In NCUA Legal Opinion Letter 92-0505, which is no longer available on NCUA's website, NCUA did give some guidance.

> *"It has long been our position that the effective rate of interest must be recalculated when a loan is prepaid or a line of credit is closed. It is only at that time, when the actual term of the loan or line of credit is known, that the true effective rate of interest can be determined. If, when recalculated, the effective rate of interest exceeds the usury ceiling, the FCU must refund the excess interest collected. In our view, the recalculation of the interest rate and any resultant refund of interest are necessary to ensure compliance with the usury ceiling."*

VARIOUS FEDERAL CREDIT UNION LENDING ISSUES

Written Policies and Procedures

Section 701.21(c)(2) requires the board of directors of each federal credit union to establish written policies for loans and lines of credit consistent with the relevant provisions of the FCU Act, NCUA's regulations and other applicable laws and regulations.

MORE INFORMATION: When conducting research on a lending issue, never forget to consider the credit union's own written policies and procedures. In Legal Opinion Letter 92-0309, NCUA indicated that credit unions that issue loans outside of their own policies and procedures have violated NCUA's general lending rule.

10 Percent Limitation

Under section 701.21(c)(5), no loan or line of credit advance may be made to any member if the loan or advance would cause that member to owe the federal credit union an aggregate amount exceeding 10 percent of the credit union's total unimpaired capital and surplus. Keep in mind that for member business loans (discussed later in this section), additional limitations apply.

This limitation is a way that the FCU Act controls concentration risk. If too high a percentage of a credit union's assets are in one loan or with one member, the entire credit union might be at risk if that solitary member defaults. NCUA expects credit unions to control concentration risk beyond this specific limitation. For a detailed view concerning the agency's expectations on concentration risk, read NCUA Letter to Credit Unions 10-CU-03 and the accompanying Supervisory Letter.

General Prepayment Penalty Ban

The FCU Act includes a general ban on federal credit unions charging prepayment penalties and this is implemented at section 701.21(c)(6). This means that a member may repay a loan, or outstanding balance on a line of credit, prior to maturity in whole or in part on any business day without penalty.

Recoupment of Waived Fees and Costs

In NCUA Legal Opinion Letter 08-0731 and NCUA Legal Opinion Letter 96-0522, NCUA indicated that federal credit unions can recoup waived fees and costs that were provided to a member when the loan was granted. NCUA's rationale is that the waived fees and costs were a benefit to the member and the credit union's recoupment of those fees and costs means that the member has lost the benefit (rather than the credit union charging a prepayment penalty).

Government Insured or Guaranteed Loans

A federal credit union may charge a prepayment penalty if it is making a loan that is insured by, guaranteed by or with an advance commitment to purchase by an agency of the federal or state government. Section 701.21(e) states that loans under these programs can be made with the terms and conditions permitted by the program. NCUA Legal Opinion Letter 03-0911 states that one of these terms can be a prepayment penalty, if the program permits it.

Compensation and Lending

Generally, no federal credit union official (member of the board or a volunteer committee) or employee (or even the immediate family member of an official or employee), may receive any commission, fee or other compensation in connection with any loan made by the credit union. As with most general rules, there are exceptions. Specifically, NCUA's general lending regulation lays out four exceptions to the general prohibition against compensation tied to lending.

RESEARCH TIP: NCUA has issued numerous legal opinion letters on what payments constitute compensation for officials under section 701.33. These can be helpful guidance.

The general prohibition does not restrict:

1. Payment, by a federal credit union, of salary to employees;
2. Payment, by a federal credit union, of an incentive or bonus to an employee based on the credit union's overall financial performance;
3. Payment, by a federal credit union, of an incentive or bonus to an employee, other than a senior management employee, in connection with a loan (or loans) made by the credit union, as long as the federal credit union's board of directors establishes written policies and internal controls in connection with the incentive/bonus program and monitors compliance with those policies and controls at least annually.
4. Receipt of compensation from a person outside a federal credit union by a volunteer official or non-senior-management employee of the credit union, or an immediate family member of a volunteer official or employee of the credit union, for a service or activity performed outside the credit union, as long as no referral has been made by the credit union or the official, employee or family member.

Loans and Lines of Credit to Officials

A federal credit union's board of directors has a great deal of power and influence. For that reason, subsection 701.21(d) of NCUA's lending regulation mandates an internal control that creates a layer of board review for certain loans to officials. For purposes of NCUA's lending rules, an official is any member of the board of directors or a volunteer committee. The board of directors must review and approve (or deny) an application on which an official is a direct obligor, endorser, cosigner or guarantor if the following formula produces a total more than $20,000. To calculate the threshold, first add the following:

- The amount of the current application;
- The outstanding balances of loans, including the used portion of an approved line of credit, extended to or endorsed, cosigned or guaranteed by the official; and
- The total unused portion of approved lines of credit extended to or endorsed, cosigned or guaranteed by the official.

Then, from that total, subtract the following:

- The amount of shares pledged by the official on loans or lines of credit extended to or endorsed, cosigned or guaranteed by the official.
- The amount of shares to be pledged by the official on the loan or line of credit applied for by the official.

If a total of more than $20,000 is reached, the board must review the official's loan application.

Non-Preferential Treatment

The rates, terms and conditions on any loan or line of credit either made to, endorsed or guaranteed by an official may not be more favorable than the rates, terms and conditions for comparable loans or lines of credit to other credit union members. An official "is any member of the board of directors, credit committee or supervisory committee." If credit union employees, including high-level employees like the chief operating officer, are not officials, then the prohibition against non-preferential treatment would not apply to those employees. This restriction in subsection 701.21(d)(5) also extends to loans made to:

- An immediate family member of an official, or
- Any individual having a common ownership, investment or other financial interest in a business enterprise with an official or with an immediate family member of an official.

MORE INFORMATION: In NCUA Legal Opinion Letter 06-0343, NCUA indicated the rule prohibits preferential treatment of officials regardless of whether they are also employees or receive compensation. NCUA Legal Opinion Letter 06-0924 clarified that the prohibition does not prevent credit unions from funding certain employee benefit plans for officials.

Third-Party Servicing of Indirect Vehicle Loans

NCUA's regulations include a concentration risk control for indirect lending. The control extends to all federally-insured credit unions. A federally-insured credit union may not acquire any vehicle loan (or an interest in a vehicle loan) serviced by a third-party servicer if the aggregate amount of vehicle loans and interests in vehicle loans serviced by that third-party servicer and its affiliates would exceed:

- 50 percent of the credit union's net worth during the initial thirty months of that third-party servicing relationship; or
- 100 percent of the credit union's net worth after the initial thirty months of that third-party servicing relationship.

Keep in mind that a credit union can apply for a waiver from these requirements with its regional director.

NCUA'S LOAN PARTICIPATION RULE

Loan participations are loans where more than one institution is involved as lender. The definition of a loan participation, found in section 701.22(a), is "a loan where one or more eligible organizations participate pursuant to a written agreement with the originating lender, and the written agreement requires the originating lender's continued participation throughout the life of the loan."

Loan participations can be advantageous for several reasons:

- Loan participations allow credit unions to manage risk by distributing it among several entities;
- Loan participations allow credit unions with weak local loan demand to increase their loan portfolio by teaming with credit unions with "strong" demand;
- Loan participations allow credit unions to diversify their loan portfolios, improve earnings and manage their balance sheets; and
- Loan participations allow credit unions that are at legal or internal concentration limits to distribute participations so that they can continue to originate new loans.

Written Loan Participation Policy

A federally-insured credit union that purchases a participation interest in a loan must have an internal written loan participation policy that includes:

- Underwriting standards for loan participations;
- A limit on the aggregate amount of loan participations that may be purchased from any one originating lender (not to exceed the greater of $5,000,000 or 100 percent of net worth);
- Limits on the amount of loan participations that may be purchased by each loan type, not to exceed a specified percentage of the credit union's net worth; and
- A limit on the aggregate amount of loan participations that may be purchased with respect to a single borrower or group of associated borrowers, not to exceed 15 percent of the credit union's net worth.

Credit unions can seek a waiver from the limitations on the aggregate amount from any one originating lender or any single borrower (or group of associated borrowers).

Requirements for Loan Participation Purchases

Federally-insured credit unions purchasing a loan participation must ensure the loan meets specific requirements, including:

- The loan is one the purchasing credit union is empowered to grant;
- The borrower becomes a member of one of the participating credit unions before the purchase;
- The purchase complies with existing regulatory requirements, including the purchaser's internal written loan participation policy, that would apply if the purchaser was originating the loan;
- The purchasing credit union has executed a written loan participation agreement with the originating lender; and
- The originating lender retains a certain interest in each participated loan.

MORE INFORMATION: The amount of the retained interest required is either 5% or 10%, depending on the charter type of the originating lender. See section 701.22(b)(3) for more details.

Minimum Requirements for a Loan Participation Agreement

One of the prerequisites before a federally-insured credit union can purchase a loan participation is a written loan participation agreement with the originating lender. The requirements for a loan participation agreement are set forth in section 701.22(d). The agreement, at a minimum, must be:

- Properly executed by authorized representatives of all parties;
- Properly authorized by the credit union's board of directors or a delegated committee or senior management official; and
- Retained in the credit union's offices (original or copies).

Additionally, the written agreement must, at a minimum, include provisions addressing the following:

- Prior to purchase, the identification of the specific loan participation(s) being purchased;
- The interest the originating lender will retain in the loan to be participated;
- The location and custodian for original loan documents;
- An explanation of the parties' right to access financial and other performance information about a loan to properly monitor the loan;
- An explanation of the duties and responsibilities of the originating lender, servicer and participants regarding servicing, default, foreclosure, collection and other matters involving the ongoing administration of the loan; and
- Circumstances and conditions under which participants may replace the servicer.

NAFCU NOTE

For a more detailed look at the requirements for loan participations, review this NAFCU *Compliance Monitor* article (member-only).

NCUA'S MEMBER BUSINESS LOANS AND COMMERCIAL LENDING REGULATION

NCUA's Part 723 addresses commercial lending and member business loans (MBLs). It is principles-based and establishes policy and program responsibilities that credit unions must adopt and implement for a safe and sound commercial lending program. The agency views loans that are commercial in nature as higher-risk loans. The rule also incorporates the statutory limit on the aggregate amount of member business loans that a credit union may make pursuant to section 107A of the FCU Act.

MORE INFORMATION: Under section 723.10, a federally-insured state-chartered credit union may be exempt from Part 723 if it is subject to a similar, no-less-restrictive state rule. Eight state rules are already approved.

Defining Commercial Loans and Member Business Loans

NCUA's rule draws a distinction between a commercial loan and a member business loan. Each has its own definition; however, the definition of an MBL incorporates the definition of a commercial loan.

Definition of a Commercial Loan

A commercial loan is defined in section 723.2 as any loan, line of credit, or letter of credit (including any unfunded commitments), and any interest a credit union obtains in such loans made by another lender, to individuals, sole proprietorships, partnerships, corporations, or other business enterprises for the following purposes:

- Commercial,
- Industrial,
- Agricultural, or
- Professional (but not for personal expenditure purposes).

Certain loans, however, are exempted from the definition. The following seven types of loans are excluded from the definition of commercial loan for the purposes of Part 723:

- Loans made by a corporate credit union.
- Loans made by a federally-insured credit union (FICU) to another FICU.
- Loans made by an FICU to a credit union service organization (CUSO).
- Loans secured by a 1- to 4-family residential property.
- Loans secured by a vehicle manufactured for household use.
- Loans fully secured by shares in the credit union or deposits at another financial institution.
- Loans, which, when the aggregate outstanding balances plus unfunded commitments less any portion secured by shares in the credit union to a borrower or an associated borrower, are equal to less than $50,000.

"A vehicle manufactured for household use" is a passenger vehicle, including minivans, SUVs, pick-up trucks, etc. The term does not include vehicles that are part of a fleet or vehicles used to carry fare-paying passengers.

MORE INFORMATION: While the 2016 final rule did not define fleet, the proposed rule and NCUA Legal Opinion Letter 12-0764 suggest a fleet means five or more vehicles that meet certain requirements. The final rule discussed the use of personal vehicles to generate ride-sharing revenue through apps like Uber and Lyft.

Definition of a Member Business Loan

Section 723.8 defines an MBL as any commercial loan, as defined by section 723.2 of the rule.

However, the rule excludes certain types of commercial loans from the MBL definition. The following commercial loans are *not* MBLs and are *not* counted toward the aggregate member business loan limit:

- Any loan in which a federal or state agency (or its political subdivision) fully insures repayment, fully guarantees repayment, or provides an advance commitment to purchase the loan in full; and
- Any non-member commercial loan or non-member participation interest in a commercial loan made by another lender, unless one or more credit unions are trading member business loans to circumvent the aggregate limit

Comparing the Definitions

Not all commercial loans are considered MBLs and not all MBLs are considered commercial loans. For example, there is one type of loan that is *not* a commercial loan but *is* an MBL: any loan secured by a vehicle manufactured for household use that will be used for a commercial, corporate, or other business investment property or venture, or agricultural purpose if the outstanding aggregate net member business loan balance is $50,000 or greater. These loans *must* be counted toward the aggregate member business loan limit.

Aggregate MBL Limit

Commercial loans and MBLs are defined as separate categories because there are different limits on each category of loans. NCUA requires that credit unions set limits on commercial loans, but these limits are safety and soundness considerations and must be addressed in the credit union's commercial lending policy, which is discussed in detail below. On the other hand, the definition of and limitation for MBLs is statutory and was established by Congress. NCUA implements this requirement of the FCU Act in section 723.8.

The aggregate limit on a credit union's net MBL balances is the lesser of 1.75 times the actual net worth of the credit union, or 1.75 times the minimum net worth required under section 1790d(c)(1)(A) of title

12 of the United States Code. Loans that are exempt from the MBL definition are not counted for the purpose of the aggregate loan limit.

MORE INFORMATION: **Credit unions that have obtained a Low-Income Designation from NCUA or participate in the Community Development Financial Institutions program are exempt from the aggregate loan limit for member business loans.**

Board Involvement and Experience

Before a credit union can engage in commercial lending, its board of directors must approve and adopt a commercial loan policy that complies with the requirements of the regulation. This commercial loan policy must be reviewed at least annually, and it must address the credit union's commercial lending practices, procedures and the organizational structure. The policy must be updated by the board of directors when warranted, and the board must receive periodic updates from credit union management on the performance of its commercial loan portfolio. It is important to remember that a credit union's board of directors is ultimately accountable for the safety and soundness of the credit union's commercial lending activities and must remain adequately informed about the level of risk in the credit union's commercial loan portfolio.

A credit union must ensure that its commercial lending program is overseen by staff with the appropriate expertise in managing the type of commercial lending in which the credit union is engaged. Specifically, the senior executive officer must have a comprehensive understanding of the credit union's commercial lending business model and risk management processes. Additionally, a credit union's commercial lending personnel must have experience in the following:

› Underwriting and processing for the type(s) of commercial lending in which the federally-insured credit union is engaged.
› Overseeing and evaluating the performance of a commercial loan portfolio, including rating.
› Quantifying risk through a credit risk rating system.
› Conducting collection and loss mitigation activities for the type(s) of commercial lending in which the federally-insured credit union is engaged.

Credit unions can satisfy the experience requirements in different ways. Credit unions must have sufficient expertise given the complexity and risk exposure of the loans they plan to make. Keep in mind that credit unions do not have to hire new staff to meet the experience requirements. The credit union could take steps to ensure that its internal staff has the requisite expertise to meet the requirements of the rule. For example, a credit union can conduct internal training. The credit union could alternatively use the services of a third party like a CUSO or an independent contractor. Use of a third party is permissible if, in addition to meeting the three commercial lending experience qualifications outlined above, they also are not affiliated with the borrower in any way; credit union staff exercises ongoing oversight over the third party; and the ultimate decision to grant the loan rests with the credit union. The third-party arrangement must also comply with the prohibited activities rules in section 723.7.

Commercial Loan Policies

MORE INFORMATION: Commercial loans and MBLs are also subject to the maximum maturity limits found in section 701.21. There is no exception in Part 723 to those limits. Federally-insured state-chartered credit unions are subject to applicable maturity limits under state law.

Section 723.4 requires a credit union to adopt and implement a written board-approved commercial lending policy that provides for ongoing control, measurement and management of its commercial lending program before engaging in commercial lending activities. The credit union must also establish procedures for safe and sound commercial lending. This means, at a minimum, a credit union's commercial loan policy must address each of the following:

- Type(s) of commercial loans permitted.
- Trade area.
- Maximum amount of assets, in relation to net worth, allowed in secured, unsecured, and unguaranteed commercial loans and in any given category or type of commercial loan and to any one borrower or group of associated borrowers.
- Qualifications and experience requirements for personnel involved in underwriting, processing, approving, administering, and collecting commercial loans.
- Loan approval processes, including establishing levels of loan approval authority commensurate with the individual's proficiency in evaluating commercial loan risk.
- Underwriting standards commensurate with the size, scope and complexity of the commercial lending activities and borrowing relationships contemplated.
- Risk management processes commensurate with the size, scope and complexity of the federally-insured credit union's commercial lending activities and borrowing relationships.

A credit union's commercial lending policy must also specify the limit on commercial loans made to a single obligor. A credit union's aggregate dollar amount of commercial loans to any one borrower or group of associated borrowers may not exceed the greater of:

- 15 percent of a federally-insured credit union's net worth, or $100,000; plus
- An additional 10 percent of a credit union's net worth, if the amount that exceeds the credit union's 15 percent general limit is fully secured at all times with a perfected security interest by readily marketable collateral.

EXAMPLE

For collateral to be readily marketable, it must be salable under ordinary market conditions. The NCUA's Online Examiner's Guide provides examples of financial instruments and securities that are readily marketable collateral including bullion, currency or U.S. Treasury Bills.

Under the risk management processes that a credit union must establish, it must adopt a credit risk rating system to analyze and describe the credit risk of each loan extended by the credit union. In addition to the use of a credit risk rating system, the credit union's risk management process must also include, at a minimum, the use of loan covenants for frequent financial reporting and periodic loan reviews for portfolio risk management.

Small Credit Union Exemption

Section 723.1(b)(1) provides an exemption for any credit union that is less than $250 million in assets and meets **both** of the following requirements:

- The credit union's aggregate amount of outstanding commercial loan balances and unfunded commitments, plus any outstanding commercial loan balances and unfunded commitments of participations sold, plus any outstanding commercial loan balances and unfunded commitments sold and serviced by the credit union total less than 15 percent of the credit union's net worth; and
- In a given calendar year, the amount of originated and sold commercial loans the credit union does not continue to service total less than 15 percent of its net worth.

Small credit unions meeting these conditions are exempt from the rule's requirements regarding board of director and management responsibilities and commercial lending policies in sections 723.3 and 723.4 of the rule.

NCUA has cautioned, however, that the exemption is not meant to be a means for a credit union to circumvent the rule's policy and infrastructure requirements by strategically keeping its held-in-portfolio amount below 15 percent of net worth. To avoid circumvention of the rule, the regulation makes it clear that the 15 percent exemption threshold is measured against all commercial loans originated by the credit union, including commercial loans on the balance sheet, commercial loans sold and serviced, and commercial loans sold and not serviced.

Exempt credit unions are not completely off the hook: An exempt credit union must still ensure its general loan policy covers the types of commercial loans the credit union makes, including all other applicable commercial lending requirements in Part 723.

Collateral and Security Requirements

Instead of prescriptive requirements related to collateral obligations for commercial loans, section 723.5 requires that credit unions generally adopt collateral requirements that are commensurate with the level of risk associated with the size and type of any commercial loan. If a credit union does not require a full and unconditional personal guarantee, or makes an unsecured loan, it must internally document the mitigating factors it believes sufficiently offset the relevant risk. The credit union must also adopt a policy for monitoring collateral and adopt processes to respond to changing asset values.

In addition, if the credit union chooses to extend commercial loans without a personal guarantee, credit union personnel must track those loans and periodically report these to the board of directors and senior management.

RESEARCH TIP: NCUA's Online Examiner's Guide contains many pages of guidance regarding commercial lending, including detailed information on different types of collateral and obtaining personal guarantees.

Construction and Development Lending

Construction and development loans are considered by NCUA to be very high risk. For that reason, credit unions choosing to extend these types of loans must adopt appropriate systems and personnel to protect against the added risk. Section 723.6 distinguishes between two types of construction and development loans: those for the acquisition of income-producing property and those related to projects for a commercial purpose (i.e., "a financing arrangement for the construction, major expansion or renovation" of the types of property described in section 723.6). Prior to making a construction or development loan the credit union must have a commercial loan policy that includes adequate provisions by which the collateral value associated with the project is properly determined. There are two distinct methods to determine the value of the collateral: one focused on cost to complete the project and the other on the prospective market value of the completed project. Under the rule, collateral value is the lesser of the two.

A credit union that makes construction and development loans must ensure its commercial loan policy meets the following conditions:

- Qualified personnel must review and approve any line-item construction budget prior to making the loan.
- A credit union approved requisition and loan disbursement process is established.
- Disbursement of funds only occurs after on-site inspections that have been properly documented.
- Each disbursement is made after confirmation that no intervening liens have been filed.

Prohibited Activities

Section 723.7 describes activities prohibited by NCUA's MBL and commercial lending rule. Credit unions may not issue commercial loans to the following:

- Any senior management employee – including the credit union's chief executive officer; any assistant chief executive officers (e.g., Assistant President, Vice President or Assistant Treasurer/Manager); the credit union's chief financial officer (Comptroller) – if they are directly or indirectly involved in the credit union's commercial loan underwriting, servicing and collection processes; or
- Any associated borrower or immediate family member of anyone listed above.

Federal credit unions may not grant a commercial loan if any additional income received by the credit union or senior management employees is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

A credit union may not grant a commercial loan to a compensated director unless the board of directors approves granting the loan and the compensated director is recused from the decision-making process.

In addition, any third party providing advice or support to the credit union in connection with its commercial loan program may not have any interest in the loans it is responsible for reviewing, nor have any expectation for receiving compensation of any sort that is contingent on the closing of the loan, with limited exceptions.

Small Business Administration Programs

If a federal credit union makes a member business loan as part of a Small Business Administration (SBA) guaranteed loan program with loan requirements that are less restrictive than those required by NCUA, then the federal credit union may follow the loan requirements of the relevant SBA guaranteed loan program to the extent they are consistent with Part 723. (A state chartered credit union should look to its state regulator to see if it has the authority to do this).

CHAPTER 3 — LENDING

SECTION 2 — REGULATION Z – INTRODUCTION

OVERVIEW

Regulation Z implements the Truth in Lending Act (TILA). Initially, Regulation Z was a disclosure-based regulation; however, over the years it has been amended to also include specific prohibitions and other operational rules. In addition, the disclosure portion of Regulation Z has been enhanced and includes very detailed requirements for format, content and even font size or bolding requirements. The sections that follow cover the main aspects of Regulation Z; however not every detail is discussed. Credit unions should look to the regulation and staff commentary for a full explanation of the requirements.

REGULATION Z'S COVERAGE

Regulation Z does not cover all lending situations. For instance, Regulation Z does not apply to loans made for business, commercial or agricultural purposes. It also does not apply to loans made to non-natural persons. NCUA's general lending and member business lending regulations, however, may still apply in these situations.

Regulation Z also does not apply to loans with an amount financed of greater than the threshold amount contained in comment 1 to section 1026.3(b) which is adjusted each year for inflation. However, the following loans are subject to Regulation Z even if they exceed the threshold amount: loans secured by real property, loans secured by personal property used as a member's principal dwelling or private education loans. Beginning January 1, 2023, the bureau set this threshold amount at $66,400. Of course, the credit union does not need to treat these loans as exempt and can follow its normal disclosure and lending procedures, even if the loan exceeds $66,400. In practice, most credit unions provide disclosures for all consumer loans.

MORE INFORMATION: In addition to the staff commentary, the CFPB also maintains a webpage where the new threshold is published each year and historical thresholds are maintained.

FINANCE CHARGES

One of the keys to Regulation Z is the disclosure of finance charges that help a member determine the cost of receiving the credit. Here is the definition from section 1026.4(a):

> *"The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction."*

Determining which charges and fees are finance charges under Regulation Z is a difficult task. Generally, it is not the name of the fee or charge but, rather, how the charge impacts the member which determines whether the charge is a finance charge or not. Section 1026.4(b) includes a listing of fees or charges considered finance charges and section 1026.4(c) lists fees and charges specifically excluded from being finance charges. In the exclusion list, there are sometimes specific requirements the fee must meet in order to be excluded.

EXAMPLE

One of the exclusions listed in section 1026.4(c)(1) is "application fees charged to all applicants for credit, whether or not credit is actually extended." An application fee charged only to members who are approved for credit would be a finance charge for Regulation Z.

Determining whether a fee or charge is a finance charge is important because finance charges impact the member's Annual Percentage Rate (APR), whereas charges that are not considered finance charges are excluded from the APR calculation.

Ultimately, whether a fee or charge is considered a finance charge for Regulation Z purposes will depend on the facts and circumstances of the charge or fee. The lists in Regulation Z and staff commentary can help the credit union make these determinations.

RESEARCH TIP: The Federal Reserve *Consumer Compliance Outlook* article provides more details on the types of fees and charges that could be considered finance charges.

APR VERSUS APOR

Regulation Z contains requirements that apply only to certain mortgage transactions that are considered to be risker to consumers. These mortgages have additional requirements that credit unions must follow and additional protections for borrowers.

One prominent way Regulation Z determines which requirements apply to a particular transaction is a comparison of the mortgage loan's "annual percentage rate" (APR) versus the "average prime offer rate" (APOR). This comparison determines whether a credit union's mortgage loan is considered a "higher-priced mortgage loan" or a "high-cost mortgage loan." When a credit union's mortgage falls into one (or both) of these categories, the rules require credit unions to follow additional requirements and refrain from taking certain actions. These rules are discussed further in Chapter 3, Section 7.

OPEN-END VERSUS CLOSED-END

A key distinction when working with Regulation Z is determining which rules apply. This starts with a determination of whether the loan product is open-end credit or closed-end credit. For example, the advertising rules are different for each type of credit and the credit union needs to know which rules to follow in order to be compliant. Similarly, the account opening disclosures differ as does the requirement for a periodic statement. Often, the first follow-up question to a Regulation Z issue will be: "Is this for open-end or closed-end credit?" This answer will identify the appropriate information and answer in Regulation Z.

Section 1026.2(a)(20) explains "open-end credit" is a credit plan that meets the following criteria:

- The credit union reasonably contemplates repeated transactions;
- The credit union imposes a finance charge on the outstanding balance; and
- The amount of available credit is replenished as the outstanding balance is repaid.

Any credit plan meeting these requirements is considered open-end credit. Under section 1026.2(10), all other credit plans are closed-end credit plans.

Multi-Featured Lending Plans

Some credit unions offer loan products under a master lending plan, which was considered a hybrid credit plan. Under a master lending plan, a member may request additional extensions of credit, but each request is subject to its own underwriting standards and repayment terms. These plans are referred to as "multi-featured lending plans."

RESEARCH TIP: For more details on multi-featured lending plans and NCUA's guidance on these plans, refer to Letter to Federal Credit Unions 10-FCU-02 and Letter to Federal Credit Unions 12-FCU-02.

In accordance with Regulation Z, NCUA has opined that each loan must be either open-end or closed-end. NCUA issued Legal Opinion Letter 11-0620, which explains "multi-featured lending plans" that involve a master agreement – with both closed-end and open–end subaccounts – is allowed under Regulation Z. However, the credit union would be required to provide closed-end Regulation Z disclosures for any closed-end loans under the plan, and open-end Regulation Z disclosures for open-end credit.

DEFINITION OF DWELLING

A very important definition for Regulation Z is "dwelling." This definition determines whether requirements apply to a particular transaction as many requirements only apply to credit secured by a dwelling. Section 1026.2(a)(19) includes the definition:

> *"Dwelling means a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and trailer, if it is used as a residence."*

The staff commentary clarifies that the determining factor is whether the property is used as a residence:

> *"1. Scope. A dwelling need not be the consumer's principal residence to fit the definition, and thus a vacation or second home could be a dwelling. However, for purposes of the definition of residential mortgage transaction and the right to rescind, a dwelling must be the principal residence of the consumer. [...]*
> *2. Use as a residence. Mobile homes, boats, and trailers are dwellings if they are in fact used as residences, just as are condominium and cooperative units. Recreational vehicles, campers, and the like not used as residences are not dwellings."*

Of course, some Regulation Z requirements apply only to "principal dwellings," so be sure to review the scope of each requirement to determine which loans are covered.

CHAPTER 3 — LENDING

SECTION 3 – REGULATION Z – OPEN-END CREDIT

OVERVIEW

For open-end credit, Regulation Z requires account opening disclosures prior to the first transaction occurring and other disclosures throughout the life of the account relationship such as periodic statements and change-in-terms notices. For credit card accounts and home equity lines of credit, disclosures are also required during the application process. Importantly, different rules apply depending on which type of credit is being offered and the terms of the loan product – such as additional requirements if an introductory annual percentage rate (APR) applies to the account.

HOME-EQUITY LINE OF CREDIT DISCLOSURES

Regulation Z includes special disclosure requirements for home equity lines of credit (HELOCs) due to their unique nature as home-secured open-end products. Regulation Z requires application disclosures, account opening disclosures and periodic statements for HELOCs. These rules are separate and distinct from the rules applicable to other open-end loan products under Regulation Z.

NAFCU NOTE

For more on the various HELOC requirements for the entire life cycle of the credit plan, see this NAFCU *Compliance Monitor* article (member only).

Application Disclosures

Section 1026.40 contains the specific disclosure requirements for HELOC application disclosures. These disclosures are required for all HELOCs secured by a dwelling, which does not need to be a member's principal dwelling. The content requirements for the application disclosures are highly dependent on the terms of the HELOC being described. Therefore, credit unions will need to review these terms carefully when drafting the disclosures. Applicants must also receive a copy of the CFPB's informational brochure, *What You Should Know About Home Equity Lines of Credit*, or its equivalent.

Account Opening Disclosures

Section 1026.6(a) provides the account opening disclosure requirements. The account opening disclosures must be provided to the member prior to the first transaction being conducted. These disclosures differ from the account opening disclosures for other open-end credit disclosures such as personal lines of credit or credit cards. Many of these disclosures are similar to the application disclosures. In fact, section 1026.6(a) refers to the application disclosure requirements in section 1026.40(d) and requires some of these disclosures be provided again at account opening. As these disclosures look back to the application disclosures, understanding the terms of the loan program is key to ensuring accurate disclosures.

RESEARCH TIP: **A key when reviewing both the application and account opening disclosure requirements for HELOCs is to consult the staff commentary of Regulation Z for sections 1026.40 and 1026.6(a) as both sections contain invaluable clarifying information about the specific disclosure requirements.**

Periodic Statements for HELOCs

Regulation Z requires periodic statements for all open-end credit – including HELOCs. The HELOC periodic statement is unique, but Regulation Z allows the credit union the option of following either the HELOC-specific rules in section 1026.7(a) or following the periodic statement requirements from section 1026.7(b), which apply to other open-end credit. Credit unions will need to determine which section they wish to use for their HELOCs.

Special Rules for HELOCs

HELOCs come with special protections under Regulation Z. The most prominent location for these special protections is section 1026.40(f), which places limitations on changing terms, terminating plans and demanding repayment of HELOCs. Unlike other open-end credit products, credit unions cannot unilaterally change the terms of a HELOC contract. While there are some exceptions to the prohibitions, a key point to remember is that the terms of HELOC contracts are very difficult to change.

For example, a credit union cannot change the margin on an existing HELOC. Similarly, the credit union could not add a floor to an existing HELOC to protect against interest rate risk, though NCUA Legal Opinion Letter 10-0214 indicated this may be possible where the original contract gives the credit union the ability to do so or the member agrees to the addition in writing.

Section 1026.40(f) also describes the situations when a credit union can prohibit additional credit advances or reduce the credit limit on an existing HELOC. Credit unions will want to review this section and the accompanying examples in the staff commentary before taking any of these actions. An example can help explain the importance of the staff commentary. One of the times section 1026.40(f) allows credit unions to prohibit additional credit advances or reduce the credit limit on an existing

HELOC is when "the value of the dwelling that secures the plan declines significantly below the dwelling's appraised value for purposes of the plan." So, how much does the value need to drop before it is considered a "significant decline"? The staff commentary includes this information:

> *"6. Significant decline defined. What constitutes a significant decline for purposes of § 1026.40(f)(3)(vi)(A) will vary according to individual circumstances. In any event, if the value of the dwelling declines such that the initial difference between the credit limit and the available equity (based on the property's appraised value for purposes of the plan) is reduced by fifty percent, this constitutes a significant decline in the value of the dwelling for purposes of § 1026.40(f)(3)(vi)(A). For example, assume that a house with a first mortgage of $50,000 is appraised at $100,000 and the credit limit is $30,000. The difference between the credit limit and the available equity is $20,000, half of which is $10,000. The creditor could prohibit further advances or reduce the credit limit if the value of the property declines from $100,000 to $90,000. This provision does not require a creditor to obtain an appraisal before suspending credit privileges although a significant decline must occur before suspension can occur."*

If the credit union does change a term on a HELOC account, section 1026.9(c)(1) requires it to provide a change in terms notice at least 15 days prior to the effective date of the change. As indicated above, some terms cannot be changed unilaterally by the credit union.

The advance notice requirement does not apply to situations where the credit union prohibits additional advances or reduces the credit limit on an existing HELOC. In those situations, a notice is required under section 1026.9(c)(1)(iii) and it must be sent within three business days of the action being taken. The notice must also include the specific reasons for the credit union's action.

MORE INFORMATION: **Check out these additional resources that provide further details on the requirements for HELOCs: NCUA's Interagency Guidance on Home Equity Lines of Credit Nearing Their End-of-Draw Period and this Federal Reserve *Consumer Compliance Outlook* article on HELOC compliance implications.**

NOT HOME-SECURED OPEN-END CREDIT DISCLOSURES

Not home-secured open-end credit means open-end loans that are not home-equity lines of credit (HELOCs). Examples include credit card accounts, personal lines of credit and overdraft lines of credit.

Application Disclosures for Credit Cards

Regulation Z requires a specific disclosure be provided to members during the application process for a new credit card account. This disclosure must be in a tabular format and must relay the most important terms on the account – including APR(s), fees and grace period. These disclosures must be on or with any credit card solicitation or application. The specifics of the disclosures will depend on the terms of the credit union's account — such as whether there is a separate APR for cash advances and whether the purchase APR is a variable-rate.

These disclosure requirements are located in section 1026.60 with explanatory text in the accompanying staff commentary. The model forms for these disclosures are the G-10 series in Appendix G. The staff commentary to section 1026.5(a)(1) details the requirement for these application disclosures to meet Regulation Z's "clear and conspicuous – readily noticeable standard." The application disclosures must be in at least 10-point font (with a special rule for the purchase APR which must be at least 16-point font).

Account Opening Disclosures

For all open-end loans which are not home-secured, Regulation Z requires the account opening disclosures to be in tabular format. The account opening disclosures must be provided to the member prior to the first transaction being conducted. The account opening disclosures must follow section 1026.6(b) – including the formatting requirements. These disclosures must also be at least 10-point font (16-point font for the purchase APR). Sample form G-17(B) contains an example of the requirements.

These disclosures are required for credit card accounts, personal lines of credit, overdraft lines of credit as well as other, not home-secured open-end credit accounts. The best way to be sure all the required terms are included is to review section 1026.6 along with the staff commentary.

Periodic Statements

Section 1026.5(b)(2) requires credit unions to send periodic statements to members each billing cycle. This requirement applies to all open-end credit, though there are specific requirements for HELOCs (as discussed above) and credit cards.

Periodic statements must follow strict formatting and content requirements. These rules are outlined in section 1026.7 and the accompanying staff commentary. For all open-end periodic statements, credit unions need to group fees and interest charges separately from other transactions. Fees and interest charges must be totaled for the period (i.e., monthly) and year-to-date, and disclosed in a tabular format.

RESEARCH TIP: Appendix G provides several examples of the periodic statement disclosure requirements. Model Form G-18(A) demonstrates the transaction and fee disclosures for all open-end credit periodic statements. Model Forms G-18(B), G-18(C) and G-18(D) provide examples of the additional disclosures for credit card statements. Model Forms G-18(F) and G-18(G) show a comprehensive view of the periodic statement requirements.

For open-end loans (except credit card accounts, where a grace period applies), a statement must be sent at least 21 days prior to the expiration of the grace period, if applicable. For open-end loans without a grace period, a statement must be sent at least 14 days prior to the member's due date. Most open-end loans that are not credit cards do not have a "grace period" as interest begins to accrue immediately following the transaction. Thus, those loans would fall under the 14-day timing requirement.

For credit card accounts, a statement must be mailed or delivered at least 21 days prior to the member's due date. For those statements, credit unions must disclose additional information — including a late payment warning, a minimum payment warning and a repayment disclosure example.

Change in Terms Notices

For not home-secured open-end credit, section 1026.9(c)(2) requires credit unions to provide a 45-day advanced notice of a change in terms. In general, this notice must be provided whenever the credit union changes a term required to be in the account opening disclosures — such as the late fee or APR.

The notice can be included on the member's periodic statement or sent in a separate mailing. Regardless of the approach, the credit union must provide the notice in a tabular format and follow the specific content requirements. The G-20 and G-21 Model Forms in Appendix G provide examples of the disclosure requirements. For an example of the change in terms notice included on the periodic statement, see the first page of Model Form G-18(F).

The change in terms notice must contain specific information required by section 1026.9(c)(2)(iv). Not all the information must be included on each change in terms notice. For example, some of the information is only required for certain changes – such as APR increases. Additionally, there is specific information required for notices regarding credit card accounts. Be sure to review the list of disclosure requirements and determine which apply to your proposed change in terms. The model forms can also act as a useful visual guide.

APR Increases

Several of the requirements for credit card accounts deserve special mention. If the credit union increases the APR on a credit card account, it must disclose on which balances the new higher APR will apply and which balances the current APR will continue to apply. Additionally, the credit union needs to disclose a statement of up to four principal reasons for the APR increase – listed in order of importance.

Right to Reject

Changes to credit card accounts also need to include a statement about the member's "right to reject" the changes. This disclosure requirement does not apply to all changes to credit card accounts – notably it does not apply to APR increases. So, credit unions need to determine whether the disclosure is required or not. The notice must include a statement about the member's right to reject, the process for a member to reject the changes and, if applicable, the member's inability to make further transactions on the account if the member rejects the changes. Section 1026.9(h) provides the applicable rules when a member exercises their right to reject.

NAFCU NOTE

More information on the right to reject can be found in this NAFCU *Compliance Blog* post and this post covers the required disclosures.

Delinquency

Regulation Z also has a special change in terms notice requirement for situations where a credit union increases a member's credit card APR based on default, delinquency or as a penalty for violating the account terms. Section 1026.9(g) details these disclosure requirements and Model Forms G-22 and G-23 provide visuals of these requirements. The G-22 form shows the disclosure requirements for increasing an APR to the penalty rate if a member is less than 60 days late, whereas the G-23 form includes the requirement if the member is more than 60 days late.

If the terms on the account are being changed because a member was more than 60 days late, the credit union has additional disclosure requirements as it must disclose the member's ability to cure the increased APR or fee by making on-time payments for the first six months after the APR is increased. If your credit union is seeking to increase the member's APR to the penalty APR applicable to the account, be sure to review section 1026.9(g) and the accompanying staff commentary.

ADVERTISING OPEN-END CREDIT

A key to understanding Regulation Z's advertising rules is determining which rules apply to a proposed advertisement. Regulation Z has different rules depending on whether the product is a HELOC, credit card or other open-end credit product. There are as also rules for certain features, such as promotional rate offers. In order to know which rules apply, you will first need to determine what product and features are being advertised.

NAFCU NOTE

NAFCU's *Credit Union Compliance Advertising Guide* (member-only) explains the requirements for advertising the various products credit unions offer.

Misleading Terms

Section 1026.16(a) requires the content of all advertisements to be accurate. Section 1026.16(f) contains limitations on using the term "fixed" to describe a credit union's APR. The credit union can use the term "fixed" if it also includes a specified period of time the APR will be fixed. If no period of time is disclosed in the advertisement, the credit union is not able to increase the APR in the future under any circumstances. The account would need to remain at the "fixed" APR throughout the life of the relationship (similar to a fixed-rate mortgage).

Not Home-Secured Open-End Credit

Section 1026.16(b) requires additional disclosures whenever a "trigger term" is mentioned in an advertisement of not home-secured open-end credit. The trigger terms are those required to be disclosed under section 1026.6(b)(3) and include the APR, transaction fees, annual fee and certain other charges. This applies to trigger terms stated in the positive ($50 annual fee) and in the negative (no annual fee). If a credit union's open-end advertisement includes a trigger term, the following disclosures must be included:

- Any minimum, fixed, transaction, activity or similar charge that is a finance charge under section 1026.4 that could be imposed;
- The APR and if the plan provides for a variable APR, that fact shall be disclosed; and
- Any membership or participation fee that could be imposed.

This section reinforces the need to understand which of the credit union's fees are considered finance charges under section 1026.4. The credit union will need to disclose any finance charges it will charge on the account (such as cash advance fees, balance transfer fees and foreign transaction fees).

For television or radio advertisements, these disclosures do not have to be included. Credit unions can provide the APR (and a statement if the account has a variable rate) as well as a toll-free telephone number for members to call for the additional disclosure information.

Promotional Rate Advertisements

Regulation Z contains special additional disclosures in section 1026.16(g) for promotional rate advertisements for not home-secured open-end credit advertisements. If the promotional rate is related to the opening of a new account, the credit union must refer to the rate as "introductory" or "intro" and this reference must be included immediately next to each listing of the promotional rate. Additionally, for any promotional rate advertisement (including introductory rates) the following disclosures must be stated in a prominent location in close proximity to the first listing of the promotional rate:

- When the promotional rate will end; and
- The APR that will apply after the end of the promotional period.

MORE INFORMATION: The CFPB issued Bulletin 2014-02 on Marketing of Credit Card Promotional APR Offers to address some of the potential risks and UDAAP concerns when offering promotional APRs.

If the APR applicable at the end of the period will depend on a member's creditworthiness, the advertisement must disclose the specific rates or the range of rates that might apply. Disclosures included in a footnote are *not* considered "in a prominent location." The staff commentary to section

1026.16 offers illustrative examples of what practices satisfy the CFPB's "clear and conspicuous" standard.

HELOC Advertising Rules

Section 1026.16(d) also requires additional disclosures whenever a "trigger term" is mentioned in HELOC advertisements. The trigger terms are those required to be disclosed under sections 1026.6(a)(1) or 6(a)(2) or the payment terms of the plan – either in the positive or negative. References to payment terms include references to the draw period or any repayment period, the length of the plan, how the minimum payments are determined and the timing of such payments. Additionally, phrases such as "we waive closing costs" or "no points" are considered trigger terms. If a trigger term is stated, the credit union needs to include the following in the advertisement:

- Any minimum, fixed, transaction, activity or similar charge that is a finance charge under section 1026.4 that could be imposed;
- Any membership or participation fee that could be imposed;
- Any loan fee that is a percentage of the credit limit under the plan and an estimate of any other fees imposed for opening the plan, stated as a single dollar amount or a reasonable range;
- The APR and if the plan provides for a variable APR, that fact shall be disclosed; and
- The maximum APR that may be imposed in a variable-rate plan.

There are also special HELOC advertising requirements if the credit union's advertisement includes any of the following:

- *Discount or Premium Initial Rates* – where the advertised initial APR is not based on the same index and margin used for later rate adjustments under the plan as discussed in section 1026.16(d)(2).
- *Balloon Payments* – where the advertisement states any minimum payment and a balloon payment may result if a member makes only those minimum payments as discussed in section 1026.16(d)(3).
- *Tax Implications* – where the advertisement mentions the potential availability of a tax deduction for interest expenses under a HELOC plan as discussed in section 1026.16(d)(4).
- *Promotional Rates and Payments* – where the advertisement includes a promotional APR or a promotional payment amount as discussed in section 1026.16(d)(6).

Credit unions will want to review the regulatory text and the accompanying staff commentary for more information on these requirements if they apply to the credit union's products.

CHAPTER 3 — LENDING

SECTION 4 — REGULATION Z – SPECIAL CREDIT CARD RULES

SPECIAL RULES APPLYING TO CREDIT CARD ACCOUNTS

Regulation Z has special protections for credit card accounts that stem from the Credit CARD Act. This section highlights a few of these protections, but it is not an attempt to provide a comprehensive explanation of all the protections applicable to credit card accounts.

ABILITY TO PAY

Section 1026.51 requires credit unions to consider a member's ability to pay the required minimum payment prior to opening a new credit card account or increasing a credit limit on an existing account. Credit unions are required to have reasonable written policies and procedures to review a member's ability to pay.

Reasonable policies and procedures include treating any income and assets the member has a "reasonable expectation of access" to as the member's income or assets or limiting consideration of the member's income or assets to the member's "independent income and assets." While credit unions have flexibility in their treatment of income, the broader "reasonable expectation of access" allows credit unions to better serve stay-at-home spouses and other members who may not have their own independent ability to pay. The reasonable policies and procedures must also include consideration of at least one of the following: the ratio of debt obligations to income; the ratio of debt obligations to assets or the income the member will have after paying debt obligations.

EXAMPLE

The staff commentary provides additional information on the types of income that may be considered independent income or assets: the applicant's salary or bonus, interest income, retirement benefits, alimony or child support and income deposited into an account in which the applicant has an ownership interest, such as a joint account. An applicant has a reasonable expectation of access to any funds from a non-applicant used to regularly pay the applicant's expenses.

Section 1026.51(a)(2) provides a reasonable method and a safe harbor for calculating the required minimum payment to help credit unions perform the ability to repay review.

Members Under 21

Section 1026.51(b) contains additional requirements for assessing the ability to repay for members under the age of 21. A member under 21 needs to be able to qualify using their own independent income to meet the ability to repay requirement discussed above or have a joint owner or guarantor on the account who is at least 21 years old and has the ability to repay. Importantly, members under the age of 21 cannot use the "reasonable expectation of access" test to demonstrate their ability to repay. Rather, they must either have their own independent income or apply for the credit card with a joint member or guarantor who is at least 21 years old.

EXAMPLE

Independent income, as explained in the previous example, may also be considered for members under 21. However, any funds from a non-applicant used to regularly pay the applicant's expenses may not be considered.

In the situation where a member under 21 has a joint owner or guarantor on the credit card account, the credit union needs to make sure that the joint owner or guarantor agrees to any future credit limit increases. In other words, the joint owner or guarantor must agree in writing before a credit union may increase the credit limit on a credit card account for a member under the age of 21. If the member had met the ability to repay requirement through his or her own "independent income," then the credit union would need to verify the member's independent income before increasing the credit limit.

ALLOCATION OF PAYMENTS

Credit unions are required to process credit card payments in excess of the minimum payment in a specific order. For any payment amount in excess of the required minimum payment, section 1026.53(a) requires credit unions to apply the payment to the balance on the account with the highest annual percentage rate (APR). This provision ensures members are able to pay down their highest APR balances before paying down balances with a lower APR.

This provision does not dictate how the credit union applies the actual minimum payment to the account. The credit union has the option to apply this amount to any of the balances on the credit card account, in accordance with the credit card agreement.

LIMITATION ON AMOUNT OF PENALTY FEES

Section 1026.52(b) provides a limitation on penalty fees, such as late payment fees. The section includes safe harbor levels credit unions can use to comply with the limitation. For 2022, the safe harbors allow the credit union to charge up to a $30 penalty fee for the first violation and up to $41 for a subsequent violation of the same type within the next six-month period. The credit union is not required to use these safe harbor levels and could use lower thresholds. Credit unions could also attempt to calculate their own fees based on the costs incurred and use those fees if higher than the safe harbor level. The calculation is not easy and must be reevaluated every 12 months.

Reasonable and Proportional Fees

Regulation Z also contains a rule that trumps the safe harbor levels. Section 1026.52(b)(2) prevents a credit union from charging a fee in excess of the amount of the transaction that resulted in a violation. For example, if a member is late making a payment on an account with a minimum payment of $15 – the credit union cannot charge more than a $15 late fee. Thus, even though the safe harbor says the credit union could charge up to $30, the credit union is not allowed to charge a fee higher than the amount of the transaction. Similarly, if a member sent a check for $20 to meet its minimum payment and the check was returned, the credit union would only be able to charge a returned payment fee of $20. The section also prohibits credit unions from charging fees for transactions without a cost involved – including fees for declining a transaction, inactivity fees and account closure fees.

Additionally, section 1026.52(b)(2)(ii) prevents the credit union from charging more than one penalty fee based on a single event or transaction. For example, if the member's returned check results in the member also being late on the credit card account, the credit union cannot charge both a late fee and a returned payment fee. The credit union can determine whether to charge a late payment fee or a returned payment fee, but it cannot charge both as the fees apply to the same event or transaction.

NAFCU NOTE

For more details on the allocation of payments and penalty fees, check out this NAFCU *Compliance Monitor* article (member only).

LIMITATION ON FEES DURING THE FIRST YEAR

Under section 1026.52(a), during the first year a credit card account is open, credit unions may not charge fees in excess of 25 percent of the member's credit limit. Thus, if a member receives a card with a $1,000 credit limit, the credit union would not be able to charge more than $250 in fees during the first year of the account. Any additional fees incurred would need to be waived by the credit union. An increase in the credit limit during the first year does not allow the credit union to charge additional fees. Additionally, if the credit union decreases the credit limit during the first year, it is only allowed to charge a total of 25 percent of the lowered credit limit in fees during the first year. Any fees the credit union had already charged above the 25 percent threshold would have to be refunded.

Late payment, returned check and over-the-limit fees are specifically excluded from this fee calculation. It also does not apply to fees the member does not have to pay but elects to do so – such as a fee for expedited payment or a fee for reissuing a member's credit card.

LIMITATIONS ON INCREASING RATES OR FEES

Section 1026.55 contains prohibitions on increasing the APR or certain fees on a credit card account unless an exception applies. Only the following fees are covered under this regulation: fees for issuance or availability, such as a fee to open the plan or an annual fee; any fixed finance charge; any minimum interest charge and fees for any required credit insurance, debt cancellation or debt suspension coverage. In other words, to increase the APR or these fees on a credit card account, a credit union needs to review the exceptions and be sure its proposed APR or fee increase falls into one of the exceptions. The subsections below discuss these exceptions, but be sure to review the actual text of the regulation and the staff commentary before increasing an APR or fee.

NAFCU NOTE

This NAFCU *Compliance Blog* post discusses section 1026.55 and the limitations on changing the terms – such as APR and fees – of a credit card, as well as the exceptions that may apply.

Advance Notice Exception

Section 1026.55(b)(3) permits a credit union to increase an APR or fee on a credit card account if it uses the 45-day change in terms process under sections 1026.9(c) or 1026.9(g). The credit union cannot apply the increased APR or fee to an existing balance or to transactions conducted within 14 days of the notice. Thus, a credit union can raise a member's APR or fees but it can do so only for future transactions. As indicated below, this exception cannot be used in the first year after a member opens an account.

The timing can be challenging as the credit union needs to send a notice at least 45 days before the effective date of the change but the change can only apply to transactions which occur more than 14 days after the notice is sent. This results in the credit union being able to charge the higher APR on transactions conducted more than 14 days after the notice only after the end of the 45-day notice period (the credit union would need to charge the current APR until the effective date of the change). To mitigate the timing challenges, some credit unions choose to apply the higher APR to transactions conducted after the end of the 45-day period.

The increase in APR only applies to transactions in the future. This results in the creation of "protected balances" on the credit card account. Credit unions cannot demand immediate repayment of these protected balances and section 1026.53 requires any payment in excess of the minimum payment to be applied to the highest APR first. As a result, protected balances may remain on a member's account for a significant period of time.

NAFCU NOTE

This NAFCU *Compliance Monitor* article provides an in-depth discussion of protected balances and the applicable rules (member only).

Prohibition on Changes During First Year

Section 1026.55(b)(3)(iii) prohibits a credit union from increasing a member's APR or fees during the first year the account is opened. If the credit union is discussing an across-the-board rate or fee increase it must be sure not to apply the increase to members who have opened their accounts within the prior twelve months. This provision was included in the Credit CARD Act to prevent against card issuers disclosing a low APR or fee schedule and then quickly increasing the APR and fees using the 45-day change in terms process. After the first year, credit unions can increase the APR or fees using the 45-day change in terms process. Of course, this means that credit unions making across-the-board rate or fee increases will need to track accounts to determine when the first year ends and ensure the new rates or fees apply to those accounts only after the end of this period.

Variable Rate Exception

For variable-rate credit cards, section 1026.55(b)(2) explains the member's APR can be increased following an increase in the underlying index without violating Regulation Z. For example, if a credit card's index is the prime rate and there is a 25 basis point increase in the prime rate, the APR on the credit card account could increase because the increase was related to the underlying index (the prime rate).

The staff commentary clarifies credit unions can only utilize this exception if the underlying index is outside of the credit union's control. The staff commentary indicates the credit union is exercising control of the index if the variable-rate credit card contains a floor rate. If this is the case, the credit union cannot utilize the variable-rate exception.

Of note, this exception does not permit credit unions to change the margin under a variable-rate credit card account. Any changes to the credit card's margin must be performed using the advance notice exception described above.

Temporary Rate Exception

Section 1026.55(b)(1) permits a credit union to increase an APR on an account if it has properly disclosed a temporary rate applicable to the credit card account. The temporary rate period must be at least six months long and can be either an introductory APR at account opening or a temporary rate applicable to an existing account, such as purchases during December being charged at a lower APR for six months.

The credit union needs to clearly disclose the promotional rate, including the length of the promotional period and the APR applicable to any remaining balance at the end of the period. Credit unions seeking to offer a temporary rate will want to review section 1026.55(b)(1), the accompanying staff commentary and the special advertising rules in section 1026.16(g) related to promotional and introductory rates.

Other Exceptions

Regulation Z allows credit unions to increase the APR or fees on a credit card account in certain delinquency situations by providing a notice under section 1026.9(g) and following the requirements in section 1026.55(b)(4). Credit unions can also increase a member's APR or fees after the end of a workout or temporary hardship arrangement (whether completed successfully or not) under section

1026.55(b)(5). At the end of a workout, the credit union can increase the APR or fees back to the prior contractual level, but no higher.

The Servicemembers Civil Relief Act (SCRA) requires credit unions to reduce the interest rate on loans entered into prior to military service – including credit card accounts. Section 1026.55(b)(6) contains an SCRA exception allowing credit unions to increase the APR back to the contractual rate after a member leaves military service. In these situations, credit unions must follow the 45-day advance notice requirement in section 1026.9(c) before applying the higher APR to the member's account.

REEVALUATION OF APR INCREASES

Credit unions are required by section 1026.59 to reevaluate increases to the APR on credit card accounts when the increase was imposed using a 45-day change in terms notice under sections 1026.9(c) or (g). The credit union is required to reevaluate APR increases that were based on a member's individual creditworthiness as well as APR increases done on a portfolio-wide basis. The credit union is required to evaluate the decision every six months until the member's APR has been reduced to the previous level or lower.

The reevaluation is not required for changes in the APR due to a fluctuation in the index on a member's variable-rate credit card account. However, if the credit union increased the margin on the account, the credit union would need to evaluate the decision every six months.

Section 1026.59(d) allows the credit union two options to review the APR increase. First, the credit union could review the original factors which led to the increase in the APR, such as a drop in the member's credit score. Second, the credit union could review the member's account using its procedures for determining a member's APR on a new credit card account.

Reevaluation of Credit Card Accounts After a Merger

Section 1026.59(g) includes specific requirements for credit unions that acquire credit card accounts as a result of a merger and subsequently increase the APR. In practice, the acquiring credit union can comply with the reevaluation requirement by reviewing the acquired accounts using their procedures for determining a member's APR on a new credit card account. If a credit union's review of the account results in an increased APR, the credit union would need to follow the 45-day change in terms process and reevaluate the APR every six months according to section 1026.59(d).

NAFCU NOTE

NAFCU *Compliance Blog* posts on credit cards further discuss the various rules that apply to credit card accounts.

SUBMITTING AND POSTING CREDIT CARD AGREEMENTS

Section 1026.58 requires a credit union to submit the credit card agreements it offers to the CFPB on a quarterly basis and to post those credit card agreements on publicly available websites.

Submitting Credit Card Agreements to the CFPB

Section 1026.58 requires credit unions to submit certain credit card agreements to the CFPB on a quarterly basis. These submissions must be sent to the bureau no later than the first business day on or after January 31, April 30, July 31 and October 31 of each year. The submissions must contain identifying information about the credit union, including the name of the credit union, address and RSSD ID or tax identification number.

Credit unions are required to make three categories of submissions: card agreements offered to the public as of the last calendar quarter that have not been previously submitted to the CFPB, any card agreements that were previously submitted but were amended during the preceding calendar quarter and notification regarding any card agreement that the credit union is withdrawing pursuant to one of the exceptions in the rule. Credit unions are not required to make any submissions to the CFPB if, during the previous calendar quarter, none of these triggering events (i.e., new agreements, amended agreements or withdrawn agreements) have occurred.

While credit unions were originally required to submit this information via email, the CFPB finalized a rule in 2021 that updated the submission process. Credit unions are now required to submit the information through the CFPB's Collect website. NCUA also published a letter explaining this change.

De Minimis Exception

A common exception to the submission requirements is the de minimis exception for credit unions that have fewer than 10,000 open credit card accounts as of the last business day of the calendar quarter. Credit unions that qualify for the exception are not required to submit any agreements to the CFPB. When a credit union no longer qualifies for the de minimis exception, quarterly submissions to the CFPB must resume no later than the first quarterly submission deadline after the date on which the credit union offered 10,000 or more credit card accounts. The "measuring date" for purposes of this part of the rule is the last business day of the calendar quarter since that is the date used to determine whether or not the credit union qualifies for the de minimis exception under paragraph 1026.58(c)(5)(i).

EXAMPLE

The staff commentary provides a helpful explanation of this timeframe: As of June 30, a credit union offers three agreements to the public and has 9,500 open credit card accounts. No agreements need to be submitted because the de minimis exception applies. As of July 15, the credit union still offers the same three agreements, but now has 10,000 open accounts. No action is required at this time, because whether a credit union qualifies for the de minimis exception is determined as of the last business day of the calendar quarter. As of September 30, the credit union still offers the same three agreements and still has 10,000 open accounts so the de minimis exception no longer applies and the credit union must submit the three agreements to the bureau by October 31.

Posting Card Agreements on the Internet

Under section 1026.58(d), credit card agreements provided to the CFPB must also be posted on publicly available websites. These agreements may be "posted in any electronic format that is readily usable by the general public," must be "placed in a location that is prominent and readily accessible by the public" and must not require the consumer to submit any personally identifiable information in order to access the agreements. For credit unions that do not otherwise maintain websites, the staff commentary contemplates either setting up a publicly available website where these agreements may be posted or working with a vendor to provide this information on a third-party website.

CHAPTER 3 — LENDING

SECTION 5 — REGULATION Z – CLOSED-END CREDIT

OVERVIEW

The requirements for closed-end credit depend on the type of product being offered. The requirements for mortgage loans are much more complex than other closed-end credit products and are discussed in Sections 6-9 of this chapter. This section covers other types of closed-end credit products.

NOT HOME-SECURED CLOSED-END CREDIT DISCLOSURES

Not home-secured closed-end credit means closed-end loans that are not secured by a dwelling. Examples include car loans, unsecured personal loans and personal loans secured by assets other than a home, such as a share secured loan.

General Disclosure Rules

Section 1026.17(b) requires disclosures to be provided prior to consummation of a closed-end loan. Sections 1026.17(a) and (c) contain formatting rules and accuracy requirements for the required disclosures. The content requirements for closed-end disclosures are located in section 1026.18. The contents are based on the terms of the loan. A credit union will want to work with its forms providers and outside counsel to ensure the credit union's disclosures contain the required information for its loan products.

RESEARCH TIP: **Credit unions may also look to the model forms in Appendix H for additional guidance on how to provide the required closed-end disclosures.**

Refinances and Loan Modifications

There are also disclosure requirements outlined in section 1026.20 for certain post-consummation events, such as refinances and modifications. Refinancing occurs when a member's existing obligation is satisfied and replaced by a new obligation. Section 1026.20(a) and accompanying staff commentary includes five exceptions to the definition of a refinance. When a refinance occurs, the credit union must provide new closed-end disclosures to its member.

In a typical loan modification, the terms of an existing loan obligation are modified without the obligation being satisfied and replaced. In these situations, new closed-end disclosures are not required as the modification does not meet the definition of a "refinance." Whether a subsequent change in terms is considered a loan modification or a refinance will principally depend on how state law addresses loan modifications. Some states have adopted broad definitions of what constitutes a loan modification so a refinance may be rare. A credit union will want to work with local counsel to determine whether a particular transaction is a loan modification or a refinance. Regulation Z does not have any change in terms notice requirements for loan modifications but state law or the loan agreement may so those should be reviewed.

PRIVATE EDUCATION LOANS

Subpart F of Regulation Z has special requirements for private education loans. Private education loans are closed-end loans where the funds are to be used in whole or in part for postsecondary educational expenses. The requirements also apply to refinances of existing private education loans (such as consolidation loans). The exception for loans in excess of $66,400 is not applicable to private education loans.

Three sets of disclosures are required for private education loans: (1) application disclosures, (2) approval disclosures and (3) final disclosures. The application disclosures need to be included on or with the private education loan application. The approval disclosures need to be given to the member at the time the approval is communicated to the member. The member needs to be given up to 30 calendar days to accept the loan after the member has been approved under section 1026.48. If a member accepts the loan, the credit union is required to provide the final disclosures. The member has three business days after receipt of the final disclosures to cancel the loan. No funds for the loan can be disbursed until the end of the cancellation period.

MORE INFORMATION: **This Federal Reserve** ***Consumer Compliance Outlook*** **article provides an overview of Regulation Z's rules and NCUA's Supervisory Guidance on Private Student Loans highlights the risk management considerations. Section 601 of the Economic Growth, Regulatory Relief and Consumer Protection Act added additional protections and requirements for private education loans that are not yet implemented by Regulation Z. This NAFCU** ***Compliance Blog*** **post provides more insight.**

The content requirements for the private education loan disclosures are in section 1026.47. Other requirements for private education loans are located in section 1026.46 and section 1026.48.

ADVERTISING CLOSED-END CREDIT

Section 1026.24 contains the closed-end advertising rules. The rules discussed below apply to all closed-end credit products, including mortgages.

Similar to the open-end rules, section 1026.24(d) requires additional disclosures whenever a trigger term is mentioned in an advertisement for closed-end credit. The following are trigger terms for closed-end credit:

- The amount or percentage of any downpayment;
- The number of payments or period of repayment;
- The amount of any payment; and
- The amount of any finance charge.

MORE INFORMATION: The definition of *downpayment* in Regulation Z solely refers to a credit sale transaction, which is when the seller is also the creditor. Thus, the requirements for stating or disclosing a downpayment only apply when the credit union is also the seller of property to be financed, such as in a repossession or foreclosure situation.

If a trigger term is used, the additional terms are required to be included in the advertisement:

- The amount or percentage of the downpayment;
- The terms of repayment, which reflect the repayment obligations over the full term of the loan, including any balloon payment; and
- The annual percentage rate (APR), and, if the rate may be increased after consummation, that fact.

For television, radio and electronic (such as via the internet) advertisements, credit unions have flexibility for disclosing the additional terms. Section 1026.24(e) provides the options for electronic advertisements and section 1026.24(g) provides the options for television and radio advertisements.

Stating the APR is not a trigger term for closed-end credit. However, if an advertisement does mention an APR, section 1026.24(c) requires the advertisement to include a statement that the APR can increase after consummation if the loan terms allow the APR to increase.

Special Rules for Dwelling-Secured Products

Section 1026.24(f) provides requirements for advertising rates and payments for credit secured by a dwelling. If the advertisement states a simple annual rate and more than one simple annual rate will apply to a dwelling-secured closed-end loan, the advertisement must include each rate, the period of time each rate will apply and the APR on the loan. If an advertisement includes a payment amount, the advertisement must include the amount of each payment (including a balloon payment) and the period of time each payment amount will apply.

NAFCU NOTE

NAFCU's *Credit Union Compliance Advertising Guide* explains the requirements for advertising the various products credit unions offer (member-only).

Regulation Z contains additional prohibitions on dwelling-secured closed-end advertisements. These prohibitions are listed in section 1026.24(i) and cover misleading uses of the word "fixed," misleading use of comparison examples, as well as other prohibitions.

CHAPTER 3 — LENDING

SECTION 6 – SPECIAL MORTGAGE RULES – MORTGAGE ORIGINATION RULES UNDER RESPA AND REGULATION B

OVERVIEW

Mortgage lending is an especially complex area. Generally, these loans are more heavily regulated than other types of loans because mortgage loans are often consumer's largest single expense and are secured by their most significant asset. Following the 2008 recession and the subprime mortgage crises, additional laws and regulations were enacted to protect consumers. The following sections cover special requirements and prohibitions related to the origination and servicing of mortgage loans.

The two most significant laws regarding the origination and servicing of mortgage loans are the Real Estate Settlement Procedures Act (RESPA) and Truth-in-Lending Act (TILA). RESPA is implemented by Regulation X (12 CFR Part 1024). TILA is implemented by Regulation Z (12 CFR Part 1026). The Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B, also contains requirements for the mortgage settlement process. The Dodd-Frank Act of 2010 (Dodd-Frank) made significant amendments to these regulations to increase consumer protections in the mortgage origination and servicing processes. The CFPB has rulemaking authority over these implementing regulations and many of them are built to operate in tandem with each other. Credit unions should keep in mind that these requirements are in addition to NCUA's lending requirements, which are found in Section 1 of this chapter.

RESEARCH TIP: **The CFPB's Examination Manuals on Mortgage Origination and Mortgage Servicing are helpful resources in understanding the technical details of both mortgage origination and mortgage servicing.**

Sections 6 through 9 of this chapter discuss the bureau's regulatory requirements for underwriting, originating, closing and servicing mortgage loans. This section describes mortgage origination requirements and disclosures for Regulation X and Regulation B. Section 7 describes the TILA-RESPA Integrated Disclosure (TRID) requirements under Regulation X and Regulation Z. Section 8 covers special consumer protection mortgage origination rules under Regulation Z. Finally, Section 9 provides an overview of the regulatory requirements for mortgage servicing in both Regulations X and Z.

RESPA COVERAGE AND REQUIREMENTS

RESPA Coverage

RESPA applies to all "federally related mortgage loans." To be a federally related mortgage loan, the loan must have a relationship with the federal government. Section 1024.2 of RESPA contains a long list of relationships that meet this definition. The most common are loans made by a lender that is regulated or insured by an agency of the federal government such as the NCUA; the loan is made or insured by an agency of the federal government or under a federal government agency program; or the loan is to be sold to the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) or the Government National Mortgage Association (Ginnie Mae).

RESEARCH TIP: While the definition of federally related mortgage loan is technical and complex, loans made by any federally-insured credit union would likely be a federally related mortgage loan because its insurer, NCUA, is an agency of the federal government.

A federally related mortgage loan must be secured by a first or subordinate lien on residential real property upon which either a one to four family structure or a manufactured home is located or is to be constructed or placed using proceeds of the loan. This includes refinancings and loans secured by individual units of condominiums and cooperatives. It does not include a loan secured by vacant land unless the proceeds will be used to construct a one to four family structure or place a manufactured home on the vacant property within two years. Loans made primarily for business, commercial or agricultural purposes are excepted from the definition. Bridge or swing loans and certain temporary loans are also excepted.

RESPA Loan Disclosures

Loans subject to RESPA's coverage require certain disclosures during the mortgage application process and prior to closing. The disclosure requirements of Regulation X and Regulation Z operate in tandem. A lender typically does not have to provide parallel disclosures under both rules. If a disclosure is provided under Regulation Z, the RESPA disclosure may not be required.

Special Information Booklet

Under section 1024.6, a loan originator is required to provide the borrower with a copy of the Special Information booklet (referred to as the "Toolkit" by the CFPB) at the time a written application is submitted or no later than three business days after the application is received. If the application is denied before the end of the three-business-day period, the loan originator is not required to provide the booklet. If the borrower uses a mortgage broker, the broker, rather than the lender, must provide the booklet.

The booklet does not need to be provided for refinancing transactions, closed-end subordinate lien mortgage loans and reverse mortgage transactions, or for any other federally related mortgage loan not intended for the purchase of a one to four family residential property.

Good Faith Estimates (GFEs)

For loans which require RESPA disclosures, section 1024.7 requires a loan originator to provide the consumer with the standard good faith estimate (GFE) form that is designed to allow borrowers to shop for a mortgage loan by comparing settlement costs and loan terms. The GFE must be provided within three business days of receipt of an application for a mortgage loan. Under Regulation X, an application is not complete until the credit union has received all information it deems necessary to decide the application.

Regulation X requires that the estimated charges and terms for all settlement services listed on the GFE be honored by the loan originator for at least 10 business days from the date the GFE is provided. If the borrower expresses an intent to proceed with the loan prior to the expiration of those 10 business days, the loan originator is bound, within tolerances established in the rule, to the settlement charges and terms listed on the GFE. It is possible that a new GFE can be provided prior to settlement under the rule if certain circumstances are present. If a borrower does not express intent to continue with an application within 10 business days after the GFE is provided, or such longer time provided by the loan originator, the loan originator is no longer bound by the GFE.

Uniform Settlement Statement

RESPA requires the settlement agent to provide the borrower with a HUD-1 or HUD-1A Settlement Statement at or before settlement that clearly itemizes all charges imposed on the borrower and the seller in connection with the settlement. Appendix A of Regulation X contains the instructions for completing the forms. Inadvertent or technical errors on the settlement statement are not deemed a violation if a revised form is provided to the borrower within 30 calendar days after settlement. The owner or servicer of the loan must retain each completed settlement statement and related documents for five years after settlement.

RESEARCH TIP: The HUD RESPA FAQ guidance gives a good deal of information regarding how credit unions should complete the HUD-1 and GFE forms.

Relationship with Regulation Z

For open-end credit, most of RESPA's disclosures are not required if disclosures under Regulation Z are provided. The Special Information Booklet requirement is deemed satisfied if the brochure, *What You Should Know About Home Equity Lines of Credit,* required by section 1026.40(e) is provided. Similarly, the GFE requirement is deemed satisfied by the application disclosures in section 1026.40. HELOCs covered by Regulation Z are exempted from the requirement to provide a settlement statement.

For closed-end credit, there is significant overlap between transactions covered by RESPA and transactions covered by the TRID rules. The TRID rules apply to closed-end consumer credit transactions secured by real property. Only those closed-end loans which fall into the scope of RESPA but not TRID should receive RESPA disclosures, such as reverse mortgages.

RESEARCH TIP: The chart on page 5 of the RESPA section of the CFPB's Supervision and Examination Manual summarizes which loans should receive TRID disclosures and which should receive the GFE and Settlement Statement disclosures.

Homeownership Counseling List Requirement

Lenders are required to provide federally related mortgage loan applicants with a list of HUD-approved counseling organizations. This disclosure requirement is implemented in section 1024.20 of Regulation X. Although the rule requires the lender to provide the applicant with a list of homeownership counseling organizations, *RESPA* does not require the lender to confirm whether the applicant actually receives counseling.

MORE INFORMATION: There are other regulations that may have this requirement for certain higher-risk loans, discussed in more detail in Section 8 of this chapter.

The requirement applies to most federally related mortgage loans including purchase-money mortgage loans, subordinate-lien mortgages, refinances, closed-end home equity loans and home equity lines of credit (HELOCs). Reverse mortgages and mortgage loans secured by a timeshare are specifically excluded.

Content Requirements

The list of homeownership counseling organizations must be clear, conspicuous and in writing. The list must include ten HUD-approved housing counseling organizations, listed in order of proximity to the borrower's current zip code. The bureau allows credit unions to obtain the list up to 30 days prior to providing it to a loan applicant. This means that credit unions may keep frequently used lists on hand, generated based on certain data inputs and provide them to applicants as appropriate. Credit unions that keep frequently used lists on hand will need to make sure that these lists are updated at least every 30 days.

MORE INFORMATION: **The CFPB's issued Bulletin 2013-13 and a 2015 interpretive final rule to provide guidance and instructions for generating the lists in compliance with section 1024.20.**

Timing and Delivery Requirements

The list of homeownership counseling organizations must be provided to an applicant no later than three business days after a lender, mortgage broker or dealer receives an application as defined by RESPA. If the credit union denies the application or the loan applicant withdraws the application before the end of the three-business day period, the credit union is not required to provide the list. For HELOCs, the credit union has the option of providing the list in accordance with the timing and delivery requirements of section 1026.40(b) for home equity plan disclosures.

Ultimate responsibility for providing the list falls on the lender. It can be provided to the loan applicant in person or may be delivered by mail or other form of delivery. The list may also be provided electronically subject to compliance with the E-SIGN Act. The credit union can combine the list with other mortgage loan disclosures required under Regulation X or Regulation Z, unless otherwise prohibited. For situations in which there is more than one loan applicant, the credit union is permitted to provide the list to any loan applicant with primary liability on the loan.

RESPA Prohibitions

RESPA was originally established in 1974 to prohibit lenders and other settlement service providers from adding unfair fees and costs to consumer mortgages. RESPA prohibits several specific actions to protect consumers from fee packing practices.

Prohibition Against Fees for Required Disclosures

For all loans subject to RESPA, no fee may be charged for preparing the settlement statement or the escrow account statement or any disclosures required by the Truth in Lending Act, including TRID disclosures. A loan originator is also prohibited from charging a borrower any fee to obtain a GFE unless the fee is limited to the cost of a credit report.

Prohibition Against Kickbacks and Unearned Fees

The kickbacks prohibition is sometimes called "Section 8" because it is found in section 8 of the RESPA statutes. It is implemented in section 1024.14 of Regulation X and Appendix B provides guidance on the meaning and coverage of the prohibition against kickbacks and unearned fees.

RESPA prohibits parties giving one another "kickbacks" in connection with a mortgage loan. Giving or receiving a fee or a thing of value in exchange for the referral of settlement business may be a kickback under RESPA. This could apply to any person other than the consumer involved in the settlement including a title company, a lender, a real estate agent or an attorney. A thing of value is defined broadly and could include payments, commissions, fees, gifts or special privileges.

RESPA does not prohibit paying a salary or compensation for goods or facilities that are furnished or services that are actually performed. However, arrangements for payments in excess of the reasonable value of the goods or services actually being provided may be considered unearned fees or kickbacks. Appendix B of Regulation X provides guidance on the meaning and coverage of the prohibition against kickbacks and unearned fees.

NAFCU NOTE

The question of whether a particular arrangement violates the kickbacks rule is highly factually specific. The NAFCU *Compliance Blog* has discussed guidance on rentals, hosting and paying for leads. The NAFCU *Credit Union Compliance Advertising Guide* (member only) also includes helpful discussion on this issue.

Affiliated Business Arrangements

RESPA has an exception to the kickbacks rule for "affiliate business arrangements" if certain requirements are met. An "affiliate business arrangement" is an arrangement where an organization either has an affiliate relationship with a settlement service provider or a direct or beneficial ownership interest of more than one percent in the settlement service provider and the organization directly or indirectly refers settlement business to or affirmatively influences the selection of that provider.

Referring business to an affiliate under an affiliate business arrangement is not a violation of the kickback prohibition if the proper disclosures are provided to the borrower.

The organization making a referral must provide an Affiliated Business Arrangement Disclosure Statement to each person whose business is being referred. A model notice illustrating the content and format requirements for the disclosure statement can be found in Appendix D to Regulation X.

The loan originator may not require the use of such a provider, with the following exceptions: the institution may require a buyer, borrower or seller to pay for the services of an attorney, credit reporting agency or real estate appraiser chosen by the institution to represent its interest.

The affiliated settlement service provider must be a legitimate, "bona fide" provider of settlement services, not a sham or shell entity organized to circumvent RESPA's restrictions on payment of fees or other compensation for the referral of real estate settlement services business. Further, the organization making the referral can only receive a return on ownership or franchise interest or payment otherwise permitted by RESPA.

RESEARCH TIP: HUD's RESPA Statement of Policy 1996-2 Regarding Sham Controlled Business Arrangements **provides more guidance on when a settlement service provider is bona fide.**

REGULATION B APPRAISAL DISCLOSURES AND DELIVERY

In 2014, the CFPB revised Regulation B to strengthen federal appraisal requirements, as mandated by Dodd-Frank. In addition to implementing some of the federal fair lending framework, Regulation B contains requirements to provide applicants with copies of appraisals obtained in connection with an application for credit. The rule also contains requirements to provide disclosure notices. These notices inform applicants of their right to receive copies of appraisals (and valuations) obtained in connection with their application for credit.

Scope

The appraisal requirements of section 1002.14 apply to first lien mortgage loans that are secured by a dwelling. The requirements do not apply to *subordinate liens*. The requirements are not limited to principal dwellings and closed-end mortgages. This means that home equity lines of credit (HELOCs) would be subject to these requirements if the HELOCs are in a first lien position. Another important aspect of the scope is that these requirements are not limited to consumer loans. Thus, business purpose loans could also be covered under this rule.

RESEARCH TIP: Regulation B may not require credit unions to retain and provide appraisals for subordinate liens, but NCUA's regulations do provide such a requirement.

The requirement defines "dwelling" as "a residential structure that contains one to four units whether or not that structure is attached to real property." The definition is not limited " "...an individual condominium or cooperative unit and a mobile or other manufactured home."

Valuations

An appraisal is one kind of valuation, but not all valuations rise to the level of appraisals. Any estimate of the value of a dwelling developed in connection with an application for credit could be a valuation.

Valuations can include:

- A report prepared by an appraiser (whether or not licensed or certified) including the appraiser's estimate or opinion of the property's value;
- A document prepared by the credit union's staff that assigns value to the property;
- A report approved by a government-sponsored enterprise (government-sponsored enterprise (GSE) , e.g. Fannie Mae or Freddie Mac) for describing to the applicant the estimate of the property's value, developed pursuant to the proprietary methodology or mechanism of the GSE;
- A report generated using an automated valuation model to estimate the property's value; and

- A broker price opinion prepared by a real estate broker, agent or salesperson to estimate the property's value.

EXAMPLE

Not all documents that discuss or restate a valuation of an applicant's property constitute a "valuation" for purposes of the rule. For example, internal documents that merely restate the estimated value of the dwelling from an appraisal is not itself a valuation.

Notice Requirements

Regulation B requires credit unions to send a written notice disclosing the applicant's right to receive a copy of all written appraisals and other valuations developed in connection with the application for credit to be secured by a first lien on a dwelling. The disclosure must be mailed or delivered to an applicant no later than the third business day after the credit union has received the application for credit. For loans covered by TRID, the notice is included on the Loan Estimate. For all other loans, a separate notice is required.

If, at the time of application, the loan is not to be secured by a first lien on a dwelling, but the credit union later determines that the loan will be secured by a first lien on a dwelling, the credit union must mail or deliver the notice by the third business day after making the determination.

EXAMPLE

If the credit union receives an application for a HELOC that at the time of application would be in a subordinate lien position, but the credit union later determines that the HELOC would be in a first lien position, the credit union would be required to send the notice within three business days of that determination.

When there is more than one applicant, the disclosure only needs to be provided to one applicant. If a primary applicant is readily apparent, the disclosures must be provided to the primary applicant.

Model Form C-9 in Appendix C to Regulation B contains a sample disclosure. Credit unions are permitted to modify or add to the Model Form C-9 to reflect the credit union's individual policies and procedures.

Provision of Appraisals and Valuations

The rule requires a credit union to provide an applicant a copy of all appraisals and other written valuations developed in connection with an application for credit that is to be secured by a first lien on a dwelling.

Under the rule, credit unions are not permitted to charge borrowers for copies of appraisals or other written valuations. However, a credit union *may* charge a reasonable fee to reimburse the credit union's costs of obtaining the appraisal or other written valuation, so long as the fee is not increased to cover the costs of providing copies of those appraisals or other written valuations.

Copies of appraisals and other written valuations must be provided to the applicant "promptly upon completion" or no later than three business days before consummation (for closed-end credit) or account opening (for open-end credit), whichever is earlier.

An applicant can waive the timing requirement and agree to receive the copies at or before consummation or account opening. The applicant must provide the credit union an affirmative oral or written statement waiving the timing requirement no later than three business days prior to consummation or account opening.

MORE INFORMATION: The commentary states that the appraisal requirements apply even if the loan application is denied, withdrawn or incomplete, provided that the appraisal or other valuation is actually completed.

CHAPTER 3 — LENDING

SECTION 7 – SPECIAL MORTGAGE RULES – TILA/RESPA INTEGRATED DISCLOSURES RULE

BACKGROUND AND OVERVIEW

The laws for disclosures for most closed-end mortgages made to consumers come from two different federal statutes – the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA). In an effort to improve consumer understanding and avoid unexpected surprises at the closing table, Dodd-Frank directed the CFPB to integrate mortgage loan disclosures under TILA and RESPA. The result is the TILA/RESPA Integrated Mortgage Disclosures rule (TRID).

TRID is highly complex. This section provides a high-level overview of the rule's applicability, timing and delivery provisions and basic content requirements. Credit unions may take varied approaches to structuring mortgage transactions and allocating fees. The specifics on a loan-by-loan basis will require consulting the rule, its commentary and CFPB guidance. In other words, this section is not a substitute for reviewing the rules, but rather is more "TRID 101" with a focus on providing a basic understanding of the regulations.

RESEARCH TIP: The CFPB created many resources to aid in TRID compliance. The TILA/RESPA Small Entity Compliance Guide provides a helpful summary of the rule's requirements. Additional resources like FAQs, annotated and model forms, and more can be found on the CFPB's website.

SCOPE OF THE RULE AND KEY TERMS

TRID applies broadly based on transaction type. As a starting point, it is important to understand which loans require the TRID forms.

Covered Transactions

TRID applies to closed-end consumer credit transactions secured by real property or a cooperative unit. All credit unions that originate covered closed-end mortgage loans must comply with these mortgage disclosure regulations, regardless of the credit union's asset size or pricing of the mortgage (i.e., higher-priced mortgage loans).

Closed-end consumer credit transactions secured by real property can include transactions for a variety of purposes, such as: purchases, refinances and loans for second homes or vacation homes. There is no requirement that the property be the borrower's residence. TRID disclosures are also required for construction-only loans, loans secured by vacant land and loans secured by 25 acres or more. Credit extended to certain trusts for tax or estate planning purposes are also covered by TRID.

Transactions Not Covered by TRID

While TRID applies to most mortgage loan transactions, there are certain categories of loans that are excluded from the rule. TRID does not apply to:

- Home-equity lines of credit (HELOCs);
- Reverse mortgages;
- Chattel-dwelling loans, such as loans secured by a mobile home or by a dwelling that is not attached to real property; and
- Mortgage loans made by a person or entity that is not a "credit union" under Regulation Z.

MORE INFORMATION: For transactions not covered by TRID, credit unions originating these types of mortgages must continue to use other Regulation Z disclosures if applicable and the RESPA disclosures including the GFE and Settlement Statement or HUD-1. See Section 6 of this chapter for additional information about these disclosures.

Key Terms

The rule contains some key terms that help in understanding the timing and delivery requirements of the rule.

Application

TRID defines an application as the submission of a consumer's financial information for purposes of obtaining an extension of credit. Specifically, a credit union has a TRID application when it has all of the following six pieces of information:

- The consumer's name;
- The consumer's income;
- The consumer's social security number to obtain a credit report;
- The property address;
- An estimate of the value of the property; and
- The mortgage loan amount sought.

This does not mean credit unions are prohibited from requiring additional information from borrowers for the underwriting process. However, whether an application is complete from the credit union's perspective will not change whether the credit union has an application for TRID purposes.

Business Day

The term "business day" has two different meanings for purposes of TRID. One is a general or business function test definition, where "business day" is "a day on which the credit union's offices are open to the public for carrying on substantially all of its business functions." This could include Saturdays for some credit unions. The second definition, or specific definition of "business day" means "all calendar days except Sundays and the legal public holidays." Unlike the first definition of "business day," the latter definition always includes Saturday as a business day.

NAFCU NOTE

This NAFCU *Compliance Blog* post provides a detailed overview of the different definitions of business day in Regulation Z.

THE LOAN ESTIMATE DISCLOSURE

The Loan Estimate is a three-page disclosure that a credit union must provide to a consumer for most closed-end credit transactions secured by real property. The delivery requirements for the Loan Estimate are located in section 1026.19(e) of Regulation Z and the specific disclosure content requirements are in section 1026.37.

Timing and Delivery

General Requirements

The requirement to provide consumers with a Loan Estimate is triggered by the receipt of an application as defined by the rule. If a credit union has those six pieces of information and a consumer is seeking a covered loan, the Loan Estimate must be delivered to the consumer or placed in the mail no later than the third business day after the credit union receives the information. Additionally, credit unions also cannot condition providing the Loan Estimate on the consumer submitting additional verifying information related to the consumer's mortgage loan application before providing a Loan Estimate.

MORE INFORMATION: Credit unions are not required to collect all six pieces of information upfront. In the 2013 preamble to TRID, the CFPB indicated it is permitted to only seek four or five of the pieces of information to delay triggering the requirement to provide a Loan Estimate, such as not seeking the property address.

If the Loan Estimate is not provided to the consumer in person, the consumer is considered to have received the Loan Estimate three business days after it is delivered or placed in the mail. Additionally, the Loan Estimate must be provided at least seven business days before consummation, unless the consumer waives the waiting period in certain extreme circumstances.

In instances where a mortgage broker relationship is utilized, the mortgage broker may provide the Loan Estimate to the consumer on the credit union's behalf, but it is the credit union's responsibility to ensure that the content, delivery and timing requirements are met.

MORE INFORMATION: If the credit union determines that the consumer's application will not be approved within the three business day period, or if the consumer withdraws the application within that period, the credit union is not required to provide the Loan Estimate.

Business Day. Both definitions of "business day" apply in relation to the Loan Estimate. For purposes of providing the Loan Estimate within three business days from application, the definition of "business day" is the general or business function test definition ("…a day on which the credit union's offices are open to the public for carrying on substantially all of its business functions"). When calculating whether the Loan Estimate is provided at least seven business days before consummation, the specific definition applies ("all calendar days except Sundays and the legal public holidays").

Restrictions on Activities

TRID places limitations on the actions a credit union is permitted to take before providing the Loan Estimate to the consumer. Specifically, credit unions may not impose fees on the consumer before they have received the Loan Estimate and indicated an intent to proceed with the transaction. The rule also prohibits providing written estimates of terms or costs specific to consumers *unless* the credit union also provides a written statement that the terms and costs may change. Finally, the rule does not allow credit unions to require submission of documents verifying information in the consumer's application before providing the Loan Estimate.

Limitation on the Imposition of Fees

The rule prohibits imposing any fee on a consumer – application, appraisal, underwriting or otherwise – in connection with the consumer's application for a mortgage transaction until the consumer has received the Loan Estimate and has indicated an intent to proceed with the transaction. There is only one exception to this rule. This exception allows a credit union or other person to charge a bona fide and reasonable fee for obtaining the consumer's credit report before the consumer has received the Loan Estimate.

Intent to Proceed

Under the rule, a consumer can express the intent to proceed with a mortgage transaction in any manner, unless the credit union has required a particular manner of communication. However, *silence is not indicative of the consumer's intent to proceed with the transaction*.

EXAMPLE

Oral communication over the phone or in person immediately upon delivery of the Loan Estimate satisfies the rule. Written communication via email or signing a preprinted form after receipt of the Loan Estimate would also be permissible.

When a Fee is "Imposed"

A fee is generally considered "imposed" if the consumer is required to provide a method of payment, even if the payment will actually be made later. For example, the staff commentary indicates that if a credit union requires the consumer to provide a check to cover a $500 "processing fee" before the consumer has received the Loan Estimate, the credit union has not complied with the rule – even if the credit union said it would not cash the check until the consumer received the Loan Estimate, and the credit union did not cash the check until the disclosure was provided and the consumer indicated his or her intent to proceed with the transaction. Similarly, the rule does not permit credit unions to require the consumer to provide a credit card number for a processing fee before the consumer receives the Loan Estimate, even if the credit card will not be charged until after the Loan Estimate is received and the consumer has indicated his or her intent to proceed with the transaction.

Written Estimates of Costs Provided Before the Loan Estimate

A credit union can provide a consumer with a more informal estimate of terms or costs specific to the transaction before providing a Loan Estimate. However, there are certain disclosure and formatting requirements for these kinds of written estimates to ensure that they are not confused with the Loan Estimate. If a written estimate of terms or costs specific to the transaction is provided to a consumer before the consumer receives the Loan Estimate, TRID requires a specific, clear and conspicuous disclosure of a disclosure statement in no smaller than 12-point font.

MORE INFORMATION: Model Form H-26 provides a model of the disclosure statement. Additionally, use of headings, content and format substantially similar to the Loan Estimate is prohibited.

Loan Estimate Content

The Loan Estimate must be in writing and contain the specific information prescribed in subsections 1026.37(a) through (n) of Regulation Z. The disclosures are specific to the transaction and include but are not limited to general information about the loan, loan terms, closing costs, loan costs and projected information about payments. There are specific disclosures for loans with certain features such as adjustable rate mortgages.

A useful tool for tracking what information must be disclosed is the annotated Loan Estimate created by the CFPB, which has corresponding citations for each separate "box" on the form. Section 1026.37 and its commentary for each particular piece of the Loan Estimate can help inform where a particular cost belongs on the disclosure. To assist with ensuring compliant forms are being used, the CFPB also created model forms. Appendix H to Part 1026 contains the model forms, including multiple variations of each page of the Loan Estimate. Some of these forms are found in the back of this section for reference.

RESEARCH TIP: The CFPB's TILA/RESPA Guide to Forms provides illustrated instruction on how to complete the individual fields and calculations for the Loan Estimate.

Good Faith Requirement

The credit union is required to act in good faith and exercise due diligence to obtain the information necessary to complete the Loan Estimate. TRID allows credit unions to rely on the representations of other parties in obtaining the needed information. If the information is not reasonably available at the time the Loan Estimate is made, the credit union may use estimates and provide new disclosures at a later time where permitted or required under sections 1026.17(c) or 1026.19. It should be noted that when estimates are used, it must be designated as such on the Loan Estimate. Whether a Loan Estimate was issued in good faith is determined by calculating the difference between the estimated charges in the Loan Estimate and the actual charges paid by or imposed on the consumer in the Closing Disclosure.

The good faith analysis entirely relies on whether the Loan Estimate showed amounts that ended up being more than what was actually charged at consummation. A Loan Estimate is considered not in good faith if the charge paid by or imposed on the consumer exceeds the amount originally disclosed on the Loan Estimate, regardless of whether the difference was the result of a technical error, miscalculation or underestimation of a charge. A Loan Estimate is considered in good faith if the credit union charges the consumer less than the amount disclosed on the Loan Estimate, even if the amounts in the Loan Estimate were overestimated in excess of any tolerance limitations.

There are circumstances where a credit union is allowed to charge the consumer more than the amount disclosed on the Loan Estimate. Those circumstances include:

- Variations between the amount disclosed and the amount charged that are expressly permitted by TRID;
- The increase in the amount charged falls within explicit tolerance thresholds (and the estimate is not for a zero tolerance charge where variations are never permitted); or
- Changed circumstances permit a revised Loan Estimate or Closing Disclosure that permits the charge to be changed.

Tolerances

In keeping with the good faith requirement, a credit union must ensure it stays within the tolerance levels prescribed by TRID. The tolerance levels are incredibly complex and are best described by breaking them into three categories: no tolerance limitation (variations permitted), 10 percent cumulative tolerance and zero tolerance. One key factor for determining which tolerance applies to a particular mortgage related service is whether the credit union allowed the consumer to shop for that service. Even where the credit union allowed the consumer to shop, it is also important whether the consumer selects the provider on the written list of service providers the credit union gave to the consumer and if that provider is not affiliated with the credit union.

No Tolerance Limitation (Variations Permitted)

Where the original estimate, or lack of an estimate for a particular service, was based on the best information reasonably available at the time the disclosure was provided, the credit union is permitted to charge consumers more than the amount disclosed on the Loan Estimate without any tolerance or limitation for the following charges:

- Prepaid interest;
- Property insurance premiums;
- Amounts placed into an escrow, impound, reserve or similar account;
- If chosen by the consumer, fees paid to third-party service providers that are not included in the credit union's written list of service providers; and
- If chosen by the consumer, fees paid to third-party service providers for services that were not required by the credit union.

It should be noted that if the consumer is permitted to shop for settlement services, the credit union must provide the consumer with a written list of services that can be shopped. This list is separate from the Loan Estimate, but like the Loan Estimate, it must be provided within three business days from the time the credit union receives the consumer's application.

10 Percent Cumulative Tolerance

For certain charges and fees, the amounts paid by or imposed on the consumer are grouped together and subject to a 10 percent cumulative tolerance.This means the credit union may charge the consumer more than the amount disclosed on the Loan Estimate for particular charges as long as the total sum of the charges does not exceed the sum of those same charges disclosed on the Loan Estimate by more than 10 percent. The charges subject to the 10 percent cumulative tolerance are:

- Recording fees; and
- If the credit union permitted the consumer to shop, fees paid to an unaffiliated third-party service provider on the credit union's written list.

If a consumer chooses a provider for a required third-party service that is on the credit union's written list, the charge is subject to the 10 percent cumulative tolerance. However, if the consumer chooses a provider that is not on the credit union's written list, the credit union will no longer be limited in the amount that may be charged for the service. The charge is removed from consideration under the 10 percent tolerance level and instead would fall under the no tolerance limitation. To the extent the total sum of the charges added together exceeds the sum of all such charges disclosed on the Loan Estimate by more than 10 percent, any difference must be refunded to the consumer.

Zero Tolerance

For all other charges, TRID provides that credit unions are not permitted to charge consumers more than the amount disclosed on the Loan Estimate under any circumstances other than changed circumstances designated by the regulation. The zero tolerance charges include:

- Fees paid to the credit union;
- Fees paid to a mortgage broker;
- Fees paid to an affiliate of the credit union or mortgage broker;
- Fees paid to an unaffiliated third party if the credit union did not permit the consumer to shop for a third party service provider for a settlement service;
- Transfer taxes; and
- Lender credits.

A charge is “paid to” the credit union, mortgage broker, or an affiliate of either if it is retained by that person or entity. A charge is not paid to one of these entities when it receives money but passes it on to an unaffiliated third party. For charges subject to the zero tolerance threshold, any amount charged beyond the amount disclosed on the Loan Estimate must be refunded to the consumer.

If the amounts paid at closing by the consumer exceed the amounts disclosed on the Loan Estimate beyond the applicable tolerance threshold, the credit union must refund the excess to the consumer within 60 calendar days after consummation.

Here is a chart summarizing some of the basics of the tolerance limitations. Keep in mind there are many kinds of fees that can be structured in different ways. This chart is only meant as a high-level reference tool summarizing the basics of the rule.

Zero tolerance	All other fees which are not either 10 percent tolerance or subject to no tolerance. Examples include: › Fees paid to the credit union, mortgage broker, or an affiliate of either › Fees paid to an unaffiliated 3rd party if the consumer was not permitted to shop › Transfer taxes
10 percent tolerance	› Recording fees › Fees paid to unaffiliated 3rd-party when the consumer is permitted to shop
No tolerance limitation	The following IF the estimate was "consistent with the best information reasonably available"* to the credit union at the time of disclosure: › Prepaid interest › Property taxes › Property insurance premiums › Homeowner's association fees › Condominium fees › Cooperative fees › Amounts placed into an escrow or similar account › Charges paid to 3rd-party service providers selected by the consumer that are NOT on a list provided by the credit union › Charges paid for 3rd-party services NOT required by the credit union, including charges to affiliates *Note, estimates cannot be unreasonably low in order to meet this standard

THE CLOSING DISCLOSURE

TRID also requires credit unions to provide a Closing Disclosure prior to consummation of the loan. This includes much of the same information contained in the Loan Estimate but the Closing Disclosure has its own specific timing and delivery requirements.

General Requirements

The Closing Disclosure, which reflects the actual terms of the transaction, is a five-page document that contains much of the same information that is found in the Loan Estimate but with final information. The delivery requirements for the Closing Disclosure are located in section 1026.19(f) and the specific content requirements are found in section 1026.38 of Regulation Z.

Timing and Delivery

General Requirements

The credit union is responsible for ensuring that the Closing Disclosure is received by the consumer no later than three business days before consummation of the loan. The three business day waiting period means that the loan may not be consummated less than three business days after the Closing Disclosure is received.

RESEARCH TIP: The CFPB created a timeline example to help illustrate the process for meeting the TRID timing requirements for delivering disclosures in a hypothetical transaction.

To ensure the consumer receives the Closing Disclosure on time, TRID provides ways in which the credit union must arrange delivery. If the credit union delivers the Closing Disclosure to the consumer in person, it is considered received by the consumer on the day that it is provided. If the credit union mails or delivers the Closing Disclosure electronically, in compliance with the E-SIGN Act, it is considered received by the consumer three business days after it is delivered or placed in the mail. However, if the credit union has evidence that the consumer received the Closing Disclosure earlier than three business days after it is mailed or delivered, it may rely on that evidence and consider it to be received on that date.

MORE INFORMATION: In instances where a settlement agent is used to provide the Closing Disclosure to the consumer on the credit union's behalf, the credit union is still responsible for meeting the delivery requirements and remains legally responsible for any errors or defects. This is true even where the settlement agent assumes responsibility for completing some or all of the Closing Disclosure.

More Than One Consumer

If more than one consumer is involved in a transaction subject to TRID, who must receive the Closing Disclosure is dependent on whether the transaction is rescindable or not. In transactions that are not rescindable, the Closing Disclosure may be provided to any consumer with primary liability on the obligation. In rescindable transactions, however, the Closing Disclosure must be given to each consumer who has the right to rescind.

Definitions

Business Day. It is important to note that the term "business day" is defined differently for purposes of providing the Closing Disclosure than it is for purposes of providing the Loan Estimate. Business day, for purposes of providing the Closing Disclosure no later than three business days before consummation, is the specific definition (all calendar days except Sundays and the legal public holidays specified under federal law).

Consummation. It should also be noted that even though consummation commonly occurs at the same time as closing or settlement; it is a legally distinct event. Consummation refers to when the consumer becomes contractually obligated to the credit union on the credit transaction, not when the consumer becomes contractually obligated to the seller on a real estate transaction.

RESEARCH TIP: Determining when consummation occurs, i.e., when a consumer becomes contractually obligated to the credit union, is a matter of state contract law. Credit unions should consult with local counsel to determine when consummation occurs in the applicable state.

Consumer's Waiver of Waiting Period

After receiving the Closing Disclosure, the rule permits credit unions to allow consumers to waive or modify the three-business day waiting period if he or she determines that the extension of credit is needed to meet a bona fide personal financial emergency. Whether a bona fide personal financial emergency exists is determined by the facts surrounding individual situations, and the regulations only provide a few examples such as preventing a home from being sold at foreclosure. If this situation occurs, there are specific requirements that must be met for the waiver including a signed written statement that describes the emergency.

Closing Disclosure Content

Much of the content that must be provided in the Loan Estimate must also be provided in the Closing Disclosure. These disclosures are set forth in section 1026.38 and include but are not limited to: general information about the loan, loan terms, closing costs and loan costs and projected information about payments. There are also tables such as a calculation of the cash needed to close. There are also many specific disclosures relating to terms such as assumption of the loan, demand features, late payments, negative amortization, partial payments and escrow accounts.

A useful tool for tracking and researching what needs to be disclosed is CFPB's annotated Closing Disclosure that references specific rule citations to help specify which particular provision determines what must be disclosed in a particular section of the form. Like the Loan Estimate, there are model forms available to assist in compliance with the content requirements for the Closing Disclosure. The model forms are located in Appendix H to Part 1026.

RESEARCH TIP: The CFPB's TILA/RESPA Integrated Disclosure Guide to the Loan Estimate and Closing Disclosure Forms provide visuals of the form and detailed instruction on how to complete the individual fields and calculations for the Closing Disclosure.

Good Faith Requirement

The Closing Disclosure generally must reflect the actual terms and costs of the transaction. However, credit unions may estimate disclosures using the best information available when the actual term or cost is not reasonably available to the credit union at the time the disclosure is made. In doing so, credit unions must act in good faith and use due diligence in obtaining the information. Normally, like the Loan Estimate, the credit union may rely on the representations of other parties in obtaining the information.

Use of Average Charges

While the Closing Disclosure must reflect the actual terms of the transaction, under certain narrow conditions, credit unions can impose an average charge instead of the actual amount a provider received for a particular service.

NAFCU NOTE

This NAFCU *Compliance Monitor* article (member only) provides more information on using average charges.

REVISED AND CORRECTED DISCLOSURES

Revised Loan Estimates

A credit union can issue a revised Loan Estimate for informational purposes at any time. However, because the "good faith" of the Loan Estimate is determined by comparing the estimated charges originally disclosed with the actual charges paid or imposed on the consumer in the Closing Disclosure, the ability to use a revised Loan Estimate in determining good faith is very limited. The ability to use a revised Loan Estimate could be critical to making sure the disclosure has been provided in good faith.

General Rule on Revised Loan Estimates

Under TRID, a credit union can only use a revised estimate of a charge in specific situations, such as when the revision is due to a changed circumstance or a borrower-requested change. Technical errors, miscalculations or underestimated charges alone are not permissible reasons for issuing revised disclosures. Using a revised disclosure in the good faith determination is not necessary where the amounts decrease or if the amounts increase but do not exceed the applicable tolerance – in these circumstances the original Loan Estimate is still deemed to be in good faith. Also note that when using a revised disclosure in the good faith determination is permitted, a charge can only increase to the extent that the reason for the revision actually increased that particular charge.

MORE INFORMATION: **The staff commentary provides an example of a consumer-requested rate lock extension, indicating that "the revised disclosures…may reflect a new rate lock extension fee, but the fee may be no more than the rate lock extension fee charged by the credit union in its usual course of business, and other charges unrelated to the rate lock extension may not change."**

Changed Circumstances Affecting Settlement Charges or consumer Eligibility. Revised Loan Estimate charges are generally permissible when a changed circumstance causes estimated settlement charges to increase outside of tolerance or affects the consumer's creditworthiness, or the value of the security for the loan such that the consumer becomes ineligible for the estimated charge originally disclosed. Changed circumstance is defined in a limited way to three types of situations:

1. An extraordinary event beyond the control of any interested party or other unexpected event specific to the consumer or transaction;
2. Information specific to the consumer or transaction that the credit union relied upon when providing the Loan Estimate was inaccurate or changed after the disclosures were provided; or
3. New information specific to the consumer or transaction that the credit union did not rely on when providing the original Loan Estimate.

EXAMPLE

The staff commentary provides some examples of a changed circumstance, such as war or a natural disaster, or a title insurer (on which the initial estimated title insurance charge was based) goes out of business during underwriting. Another example could be inaccurate information such as relying on a stated annual income of $90,000 that is later determined to be $80,000 during underwriting.

Revisions Requested by the Consumer. Revised disclosures are also permitted when consumer requested revisions to the credit terms or the settlement cause an estimated charge to increase. The commentary provides the following example of this type of situation – "assume that the consumer decides to grant a power of attorney authorizing a family consumer to consummate the transaction on the consumer's behalf after the [Loan Estimate is] provided. If the credit union provides revised disclosures reflecting the fee to record the power of attorney, then the actual charges will be compared to the revised charges to determine if the fees have increased."

Interest Rate Dependent Charges. Sometimes, a rate is locked after the initial Loan Estimate is provided, and points or lender credits change because the rate was not locked when the initial disclosure was made. In this kind of situation, the rule requires credit unions to issue a revised Loan Estimate no later than three business days after the date the interest rate is locked. The revised disclosure must reflect the revised interest rate,

NAFCU NOTE

This NAFCU *Compliance Blog* post has more clarifications for reissuing the Loan Estimate in the context of rate locks.

the points disclosed, lender credits and any other interest rate dependent charges and terms.

Expiration of the Loan Estimate. If a consumer indicates his or her intent to proceed with the transaction more than 10 business days after the Loan Estimate was provided (or a longer period established by the credit union), a credit union can use a revised Loan Estimate as set forth in the rule. No other justification for a revised estimate is required when using a revised disclosure for this reason.

Delayed Settlement Date on a Construction Loan. Lastly, the rule permits a credit union to use a revised Loan Estimate for a new construction loan where the credit union reasonably expects settlement will occur more than 60 days after the initial Loan Estimate is required to be provided. To take advantage of this reason, the credit union must have included a clear and conspicuous statement on the initial disclosure that at any time prior to 60 days before consummation the credit union may issue revised disclosures.

RESEARCH TIP: The CFPB created additional resources for construction loans including a FAQs, a Combined Guide for disclosing the phases of a construction-permanent loan together and a Separate Guide for making TRID disclosures separately for these transactions.

Timing Requirements for Revised Loan Estimates

TRID generally requires that the revised Loan Estimate be provided within three business days of receiving information sufficient to establish that the permissible reason applies. If the revised disclosures are not provided in person, the consumer is considered to have received the revised disclosures three business days after the credit union delivers or places the revised disclosures in the mail.

The rule also prohibits a credit union from providing a revised Loan Estimate if the Closing Disclosure has already been provided. Because of the timing requirements for providing the Closing Disclosure, this means that a revised Loan Estimate must be provided not later than four business days prior to consummation. If there are less than four business days in between the time the revised Loan Estimate would have been required to be provided and consummation, credit unions may provide consumers with a Closing Disclosure reflecting any revised charges resulting from the changed circumstance and rely on those figures for purposes of determining good faith and the applicable tolerance.

"Business Day" Definition. Note that "business day" is defined differently when counting the four business day period prior to consummation compared to the three business day timeframe for providing revised disclosures. When providing the revised Loan Estimate, the general definition of "business day" applies (which means a day on which the credit union's offices are open to the public for carrying on substantially all its business functions). However, for purposes of counting the four business day period prior to consummation, the specific definition of "business day" applies, meaning all calendar days except Sundays and legal public holidays specified in federal law (e.g. Independence Day, Labor Day, Veterans Day, etc.).

Record Retention

A credit union is required to maintain records that demonstrate its compliance with TRID. As a result, if revised disclosures are provided, the credit union must be able to show compliance by documenting the original estimate of the charge, explaining the reason for the revision and showing that the timing requirements for providing the revised disclosure were met.

Corrected Closing Disclosures

Once the Closing Disclosure has been provided to the consumer, if the actual terms or cost of the transaction change and cause the disclosures to become inaccurate prior to consummation, redisclosure is required. Depending on the type of change involved, a new three business day waiting period may also be required.

Changes Before Consummation that Require a New Waiting Period

There are three types of changes that require a credit union to provide corrected disclosures and require a new three business day waiting period. These changes are:

1. **The annual percentage rate (APR) previously disclosed becomes inaccurate.** The accuracy of the APR is determined in accordance with section 1026.22. If the disclosed APR becomes inaccurate, the credit union must provide the consumer with a corrected Closing Disclosure that reflects the corrected APR and all other terms that have changed.
2. **The loan product changes.** If the loan product is changed, causing information previously disclosed about the loan product to become inaccurate, the credit union must provide a corrected Closing Disclosure that reflects the corrected loan product and all other terms that have changed.
3. **A prepayment penalty is added.** If a prepayment penalty is added, causing the statement about the prepayment penalty to become inaccurate, a corrected Closing Disclosure must be provided disclosing the prepayment penalty and all other terms that have changed.

If any of these changes occurs, the credit union must ensure that the consumer receives a corrected Closing Disclosure no later than three business days before consummation. The commentary provides several examples of changes requiring a new waiting period.

MORE INFORMATION: The CFPB addressed a 2018 statutory change regarding the extent to which the three business day waiting period applies if the APR becomes inaccurate but is a rate decrease in a FAQ (see #3).

As with the Closing Disclosure generally, a consumer may modify or waive the three business day waiting period if the consumer has a bona fide personal financial emergency that necessitates consummating the transaction before the end of the waiting period.

Changes Before Consummation That Do Not Require a New Waiting Period

For changes unrelated to the APR, such as a loan product or the addition of a prepayment penalty, section 1026.19(f)(2)(i) requires a credit union to provide the consumer with a corrected Closing Disclosure reflecting any changed terms at or before consummation, but does not require a new waiting period. Keep in mind that a consumer has the right to inspect the Closing Disclosure during the business day before consummation. If the consumer asks to inspect the Closing Disclosure on the business day before consummation, the disclosure provided for inspection must reflect any adjustment to the costs or terms that are known to the credit union at the time the consumer inspects the disclosure.

Corrected Disclosures for Post-Consummation Events

Changes that occur after consummation can also trigger the need to provide a corrected Closing Disclosure. If during the 30 day period following consummation, an event in connection with the settlement of the transaction occurs that causes the disclosures to become inaccurate and results in a change to an amount paid by the consumer from what was disclosed, the rule requires the credit union to provide a corrected Closing Disclosure. In this situation, the credit union must deliver or place in the mail a corrected Closing Disclosure not later than 30 days after receiving information sufficient to establish that such an even has occurred.

Corrected Disclosures for Clerical Errors and Refunds to Cure Tolerance Violations

Clerical errors are also subject to redisclosure. The commentary clarifies that an error is considered clerical if it is not numeric disclosure and does not affect the general and delivery requirements of TRID. To correct non-numeric clerical errors, a credit union must deliver or place in the mail a corrected Closing Disclosure no later than 60 days after consummation.

EXAMPLE

The staff commentary illustrates clerical versus non-clerical errors: "…if the disclosure identifies the incorrect settlement service provider as the recipient of a payment, then TRID requires the credit union to deliver or place in the mail corrected disclosures reflecting the corrected non-numeric disclosure no later than 60 days after consummation. However, if…the disclosure lists the wrong property address, which affects the delivery requirement imposed by [TRID], the error would not be considered clerical."

Finally, if a credit union provides a consumer with a refund to cure a tolerance violation in connection with the good faith analysis of the estimated closing costs, the credit union must deliver or place in the mail a corrected Closing Disclosure that reflects the refund no later than 60 days after consummation.

RECORD RETENTION

Regulation Z contains specific recordkeeping requirements to show compliance with TRID. A copy of the Closing Disclosure, and all documents related to the Closing Disclosure, must be retained for five years after consummation. If a credit union sells, transfers, or otherwise disposes of its interest in a mortgage and does not service the mortgage loan, then the credit union is required to provide a copy of the Closing Disclosure to the new owner or servicer. Both the credit union and the new owner or servicer must keep a copy of the Closing Disclosure for the remainder of the five-year period. The post-consummation escrow cancellation notice and the post-consummation partial payment policy must be retained by the credit union, or servicer if applicable, for two years. All other evidence of compliance with the integrated disclosure rule requirements must be maintained for three years after consummation of the transaction.

MORE INFORMATION: The staff commentary clarifies that actual paper copies of these records are not necessarily required. Rather, these records can be maintained by "any method that reproduces records accurately (including computer programs)."

CHAPTER 3 — LENDING

SECTION 8 — SPECIAL MORTGAGE RULES – MORTGAGE ORIGINATION CONSUMER PROTECTION RULES UNDER REGULATION Z

OVERVIEW

Following the 2008 recession and the subprime mortgage crisis, Dodd-Frank made a number of amendments to Regulation Z to add additional protections for mortgage consumers. Included in these changes were new or strengthened regulations regarding the underwriting and pricing of loans and additional information and disclosures consumers must have.

MORE INFORMATION: For information on mortgage disclosures, see Section 6 regarding RESPA and Regulation B disclosures and Section 7 regarding the TILA/RESPA Integrated Disclosures.

These laws are written to protect consumers who might be taking out mortgages that are seen by the bureau as riskier than others. Whether a particular transaction is subject to these additional protections often depends on the credit union's operations and the facts and circumstances regarding that individual transaction. Credit unions should consult with counsel regarding the coverage and applicability of these protections.

SPECIAL PROTECTIONS FOR HIGH-COST MORTGAGES

Section 1026.32 of Regulation Z provides additional protections and disclosure requirements for "Section 32" or "High-Cost" mortgage loans. Historically, these loans have also been called "HOEPA" loans, named for the Home Ownership and Equity Protection Act (HOEPA).

HOEPA Coverage Tests

RESEARCH TIP: The tests are complex and depend on each loan product. Section 1026.32, the staff commentary, and the CFPB's HOEPA Small Entity Compliance Guide provide further guidance about HOEPA coverage including summaries of each of these tests.

HOEPA protections apply to consumer credit transactions that are secured by a consumer's principal dwelling and meet one of three tests for coverage. Purchase-money mortgages, refinances, closed-end home equity loans and open-end home-equity lines of credit (HELOCs) are all subject to HOEPA coverage. Mortgages secured by manufactured housing and other types of personal property dwellings, such as RVs, may also be covered. Loans to purchase vacation or second homes, however, are not covered by HOEPA because the loans are not secured by the consumer's *principal* dwelling.

A consumer credit transaction secured by a consumer's principal dwelling is a high-cost mortgage if it meets any of these tests:

1. The transaction's APR, measured as of the date the interest rate is set for the transaction, exceeds the Average Prime Offer Rate (APOR) for a comparable transaction on that date by a certain threshold. The threshold varies by the dollar amount of the transaction and whether it is a first-lien or subordinate-lien transaction.

MORE INFORMATION: The Average Prime Offer Rate (APOR) is an annual percentage rate that is determined on a weekly basis using average interest rates, fees, and other terms on mortgages offered to highly qualified borrowers. It is published by the CFPB via the FFIEC's website.

2. The transaction's total points and fees exceed a specified threshold. Sections 1026.32(b)(1) and (2) defines what fees or charges to include in points and fees when making this determination. The points and fees threshold varies based on loan size.
3. The credit union charges a prepayment penalty more than 36 months after consummation or account opening, or in an amount more than 2 percent of the amount prepaid. Sections 1026.32(b)(6)(i) and (ii) define what is considered a prepayment penalty and what is considered a fee recoupment.

MORE INFORMATION: Federal credit unions are generally prohibited from charging prepayment penalties. See Section 1 of this chapter for more information.

If a consumer credit transaction is secured by a consumer's principal dwelling, meets one of the three tests for coverage and is not otherwise exempt, then the credit union must comply with HOEPA's additional disclosure requirements, restrictions on loan terms and certain practices and counseling requirement for high-cost mortgages. Reverse mortgages, loans to finance the initial construction of a dwelling, Housing Finance Agency (HFA) loans (where the HFA is the credit union) and USDA Section 502 Direct Loans are generally exempt from HOEPA coverage.

Protections for High-Cost Mortgages

Sections 1026.32 and 1026.34 of Regulation Z contain special protections that apply to high-cost mortgages. These include specific disclosures, restrictions on transaction terms, prohibited practices, repayment ability determinations and counseling requirements. Section 1026.31 also contains special timing rules for high-cost mortgages.

Specific Disclosure Requirements

Credit unions must provide special disclosures to consumers before consummation or account opening of a high-cost mortgage. The disclosures must be provided to the consumer at least three business days before consummation or account opening, must be provided in writing and must be in a form the consumer can keep. The disclosures must:

- Inform the consumer that the loan will not be effective until consummation or account opening occurs;
- Explain the consequences of default;
- Disclose loan terms such as the APR, amount borrowed and monthly payment; and
- For a variable-rate credit transaction, explain the maximum monthly payment that may be required under the terms of the loan or credit plan.

Section 1026.32(c)(1) contains specific verbiage that must be included in these disclosures. Form H-16, found in Appendix H to Regulation Z, provides sample section 1026.32(c) disclosures.

Restrictions on Transaction Terms and Prohibited Practices

Certain loan features are banned for high-cost mortgages. Section 1026.32(d) contains a list of the terms that are prohibited, including negative amortization, prepayment penalties and due-on-demand features.

In addition, section 1026.34 prohibits or restricts certain acts or practices for high-cost mortgages:

- Credit unions and mortgage brokers are prohibited from recommending default on an existing loan to be refinanced by a high-cost mortgage.
- Credit unions, servicers and assignees cannot charge a fee to modify, defer, renew, extend or amend a high-cost mortgage.
- Late fees are capped at 4 percent of the past due payment and pyramiding of late fees is prohibited.
- Fees for payoff statements are generally prohibited.

- Points and fees, as defined for HOEPA coverage, cannot be financed.
- Purposefully structuring a transaction to evade HOEPA coverage is prohibited.

RESEARCH TIP: **This is not an all-inclusive list of the prohibited practices for high-cost mortgages. Credit unions making high-cost mortgages will need to review the complete rules in sections 1026.32 and 1026.34.**

Ability-to-Repay Requirements

Credit unions are required to determine a consumer's ability-to-repay a high-cost mortgage prior to consummation or account opening. The rules differ for closed-end and open-end high-cost mortgages.

For closed-end high-cost mortgage transactions, the credit union must satisfy the ability-to-repay requirements set forth in section 1026.43 discussed later in this section.

Section 1026.34(a)(4) sets forth the ability-to-repay requirements for high-cost HELOCs. In determining the consumer's repayment ability, a credit union must generally consider the consumer's current and reasonably expected income or assets, verified with W-2s, tax returns, payroll receipts, financial institution records or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets. The credit union must also consider the consumer's current obligations – including any mortgage-related obligations such as property taxes, required insurance premiums, and community association fees.

Pre-Loan Counseling

Section 1026.34(a)(5) prohibits the credit union from extending a high-cost mortgage to a consumer unless the credit union receives *written certification* that the consumer has obtained counseling on the advisability of the mortgage from an approved counselor who is neither employed by nor affiliated with the credit union. Counseling must be received from a HUD-approved counselor or a state housing finance authority, if permitted by HUD.

The rule contains requirements for the timing of counseling, verifications the counselor must perform, and the written certification that the counselor must provide. A credit union can pay the counseling fee for the consumer; however, conditioning the payment of the fee on the consumer obtaining the high-cost mortgage is prohibited.

HIGHER-PRICED MORTGAGES

Higher-Priced Mortgage Loans, Defined

Section 1026.35 of Regulation Z contains special requirements for "higher-priced mortgage loans" (HPMLs). The HPML requirements apply to closed-end consumer credit transactions secured by the consumer's principal dwelling with an annual percentage rate (APR) that exceeds the applicable average prime offer rate (APOR). The comparison is performed as of the last date the interest rate is set or locked before consummation. The threshold for HPMLs is determined on a weekly basis using the APOR published by the CFPB on the FFIEC's website. The thresholds vary based on the type and size of the loan:

- For first lien mortgages on a member's principal dwelling, the threshold is set at 1.5 percentage points above the APOR.
- For first lien jumbo mortgages on a member's principal dwelling, the threshold is set at 2.5 percentage points above the APOR. A jumbo mortgage is a mortgage loan on a single-family property not in a high-cost area with a principal obligation greater than $726,200.
- For subordinate lien mortgages on a member's principal dwelling, the threshold is set at 3.5 percentage points above the APOR.

HPMLs are subject to the ability-to-repay requirements set forth in section 1026.43 discussed later in this section.

HPML Escrow Requirement

If a loan meets the definition of a HPML and it is a first lien, credit unions are required to establish an escrow account for property taxes and any insurance premiums required by the credit union. This requirement would not apply to subordinate liens. There are several exemptions to the escrow requirement for HPMLs. Escrow accounts are not required for loans secured by shares in a cooperative; loans to finance the initial construction of a dwelling; temporary or "bridge" loans with terms of 12 months or less; or reverse mortgages.

The rule requires that an escrow account be established prior to consummation. Maintenance of the escrow account must continue until one of the following occurs, whichever is earlier:

- The underlying debt obligation is terminated; or

- More than five years after consummation of the HPML the consumer requests that the escrow account be canceled. Under this circumstance, the loan's unpaid principal balance must be less than 80 percent of the original value of the property securing the underlying debt obligation and the consumer must not be currently delinquent or in default on the underlying obligation.

Small Creditor Exemption

This requirement has an exemption for certain small creditors operating in rural or underserved markets. A credit union can obtain this exemption from the escrow requirement for HPMLs if it meets a four-part test and does not have a forward commitment to sell its loans.

1. **Operates in Rural or Underserved Areas.** The first part of the test is whether a credit union – in either of the two preceding years – originated at least one of its first lien mortgages in counties that are determined to be "rural" or "underserved." The CFPB posts a list of these counties on its website. Current and historical lists of rural counties and rural or underserved counties can be found here.
2. **Total Annual Mortgage Originations.** The second part of the test looks at the quantity of first lien mortgage loans the credit union originated in the preceding calendar year. Credit unions – together with any affiliates (e.g., credit union service organizations (CUSOs)) – that originated 2,000 or fewer first lien mortgage loans that were sold, assigned, or otherwise transferred to another entity, would meet this part of the test. Loans that the credit union or its affiliate originate and keep in its portfolio do not count toward the 2,000 loan threshold.
3. **Asset Size Threshold.** The third part of the test looks at the asset size at the end of the preceding calendar year. This threshold adjusts annually for inflation, and is calculated by looking at assets of a credit union, together with its affiliates. This threshold is a little over $2.2 billion, and the annual updates can be found in the staff commentary.
4. **Do Not Currently Escrow for Mortgage Loans.** The fourth part of the test is whether the credit union (and its affiliates) maintains escrow accounts for any loans secured by real estate or a dwelling. Escrow accounts for HPMLs for which the credit union received an application on or after April 1, 2010 and before May 1, 2016 are not counted. Neither are escrow accounts established post-consummation "as an accommodation to distressed consumers to assist such consumers in avoiding default or foreclosure."

EXAMPLE

In other words, credit unions that only escrowed for HPMLs as required under section 1026.35 could meet this part of the test. Credit unions that escrow for all first lien mortgage loans (i.e., more than just HPMLs) would not meet this part of the test.

- **Wildcard: Forward Commitments.** Even if a credit union meets all four parts of the small creditor exemption, it would still need to follow the escrow requirements for HPMLs if – at consummation – the credit union had an agreement in place to sell the mortgage to a non-exempt credit union (such as Fannie Mae or Freddie Mac). In other words, a credit union needs to keep its HPMLs in its portfolio to qualify for the small creditor exemption. A credit union may sell HPMLs on the secondary market at a later date and maintain its small creditor status as long as the total of these sold loans do not exceed the 2,000 threshold.

NAFCU NOTE

The escrow requirements for HPMLs are quite complex. There are several resources to assist with these requirements, including NAFCU's 2013 Mortgage Rules Resources Page and this NAFCU *Compliance Monitor* article - Escrow Requirements for Higher-Priced Mortgage Loans (member-only).

HPML Appraisal Requirement

Scope

The appraisal requirements apply to any HPMLs that are not otherwise exempt from the rule. Exempted transactions include qualified mortgages, which are discussed in detail later in this section. It also includes several other types of loans, such as:

- Loans secured by a mobile home, boat or trailer;
- Loans to finance the initial construction of a dwelling (not limited to loans of 12 months or less); and
- Temporary or bridge loans (for 12 months or less).

Loans secured by manufactured homes may be potentially exempt from some or all of the appraisal requirements, depending on whether land also secures the loan and whether certain requirements are met. There are several technical exemptions to the requirement and credit unions may wish to review the exemptions in detail.

Appraisal Requirements

The HPML appraisal requirements are located in section 1026.35(c) of Regulation Z. When a credit union originates a HPML covered by the rule, it must provide an applicant with written notice disclosing their right to receive a copy of any appraisals obtained by the credit union in connection with the application and to hire their own appraiser at their own expense for their own use. This notice must be sent within three business days after receiving the application. The initial appraisal disclosures are a part of the Loan Estimate provided under the TRID rule.

For first lien HPMLs that are covered by the HPML Appraisal Rule, the disclosure requirements overlap with the Regulation B/ECOA Valuations Rule. For these first lien transactions, the credit union can add the word “promptly” to the disclosure to satisfy the disclosure requirements for both the Regulation B and HPML appraisal requirements.

MORE INFORMATION: While the Regulation B appraisal rule discussed in Section 6 of this chapter and the HPML rules may overlap, the scope of the HPML requirements is narrower than the Regulation B requirements, as it only applies to an applicant’s principal dwelling.

The credit union must obtain a written appraisal performed by a certified or licensed appraiser. The appraiser must visit the interior of the property and provide a written report. The HPML appraisal rules also establish a compliance safe harbor for appraisals meeting specific criteria. Appendix N of Regulation Z provides a list of steps the credit union can take to be sure that any required appraisal meets the requirements of the rule.

No later than three business days before consummation, the credit union must deliver copies of the appraisal(s) to the applicant. Here “business day” is defined as when “the credit union’s offices are open to the public for carrying on substantially all of its business functions.” A credit union cannot charge fees for photocopying or covering the cost of postage to provide copies of appraisals, nor can it raise the applicant’s interest rate or markup other fees to cover these costs. The appraisal copies must be delivered to the applicant no later than three business days before consummation. If there is more than one applicant, the commentary indicates that the credit union is required to give the initial disclosure and appraisal copies to only one of the applicants.

An additional appraisal may be required when a home is being resold within 180 days of its acquisition by the seller and the sale price exceeds certain thresholds. These types of transactions are commonly described as "flips."

PRE-LOAN COUNSELING FOR NEGATIVE-AMORTIZATION LOANS

Negative amortization loans are those in which the schedule of regular periodic payments causes the principal balance to increase. Negative amortization is viewed as a particularly risky feature of a loan and section 1026.36(k) requires pre-loan counseling before the loan is taken out by borrowers with no prior mortgage loan experience.

The rule applies to closed-end transactions secured by a dwelling (except reverse mortgages and transactions secured by timeshares). Before making a negative amortization loan to a first-time borrower, a credit union must receive documentation that the consumer has obtained homeownership counseling about the risks and consequences of negative amortization from a HUD-certified or HUD-approved counselor or counseling organization.

RESEARCH TIP: Pending receipt of documentation of pre-loan counseling, the commentary explains the credit union can take steps to process the application, such as ordering an appraisal or title search. However, the loan cannot be consummated until documentation that the pre-loan counseling has occurred is received.

ABILITY TO REPAY AND QUALIFIED MORTGAGES

Section 1026.43 of Regulation Z requires that a lender determine the consumer's ability-to-repay before making a closed-end mortgage loan. The determination as to whether a consumer is able to pay requires credit unions to obtain, verify and consider specific underwriting factors and to perform technical calculations under the rule. If a mortgage meets the definition of a "qualified mortgage," compliance with these requirements may be legally presumed, giving the credit union a safe harbor.

RESEARCH TIP: The CFPB maintains a number of compliance resources on the ability to repay and qualified mortgage rule including an executive summary of recent amendments to the rule on this webpage.

Types of Loans Covered

The CFPB's ability-to-repay and qualified mortgages (ATR/QM) rule applies to closed-end consumer transactions secured by a member's dwelling. Dwelling is defined as "a residential structure that contains one to four units, whether or not that structure is attached to real property." Section 1026.43(a) contains the scope of the rule, which applies to the following types of mortgages:

- Home purchases;
- Refinancings;
- Closed-end home equity loans;
- Loans secured by a first lien or subordinate lien on a dwelling;
- Loans for vacation homes; and
- Loans secured by a one-to-four-unit residence, condominium, cooperative, mobile home or manufactured home.

Importantly, the rule does not apply to open-end credit plans, home equity lines of credit (HELOCs), timeshares, reverse mortgages, temporary bridge mortgages with a term of twelve months or less, "construction loans" of 12 months or less, business-purpose loans and loan modifications.

Ability-to-Repay

Eight Underwriting Factors

Credit unions must make a reasonable, good-faith determination that a consumer has the ability to repay the loan. The rule requires that the credit union consider, at a minimum, the following eight underwriting factors before extending a covered loan:

1. Current or reasonably expected income or assets on which the consumer will rely to repay the loan (not including the value of the property securing the loan);
2. Current employment status (if the credit union relies on employment income when assessing the consumer's ability to repay);
3. The monthly payment on the covered transaction;

4. The monthly payment on any simultaneous loan secured by the same property;
5. The monthly payment for mortgage-related obligations (including any monthly payments for property taxes and insurance that the credit union requires the consumer to buy and other costs related to the property at issue, such as homeowners association fees or ground rent);
6. Current debt obligations, alimony and child support;
7. The monthly debt-to-income ratio or residual income; and
8. Credit history.

The monthly debt-to-income ratio is the ratio of the total of all the member's mortgage and non-mortgage obligations listed above (underwritten loans; simultaneous loans secured by same property; mortgage-related obligations; and current debt obligations, alimony and child support) to the member's gross monthly income.

Income can include earned income (wages or salary), unearned income (interest and dividends) and any other regular payments to the member such as government benefits. A credit union may also consider future income (such as Social Security income or annual bonuses) so long as the credit union can verify it using reasonably reliable third-party records.

RESEARCH TIP: The CFPB issued Bulletin 2014-03 clarifying how credit unions should handle certain Social Security income when making ability-to-repay determinations.

Debt should include any ongoing, required monthly, quarterly or annual debts of the consumer. Debts should not include any debts paid off at or before the loan's consummation. Credit unions are also required to consider a member's alimony, child support and other recurring financial liabilities (such as student or automobile loans, revolving debts and other mortgages). The rule affords credit unions considerable flexibility in assessing a member's other debt obligations, and a credit union may account for the likelihood that a member could pay off the obligations shortly after consummating the loan and the forbearance or deferral status of the obligations.

While the rule requires consideration of the above factors, it does not dictate that the credit union follows a particular underwriting model or use a particular debt-to-income ratio threshold. The reasonableness and good faith of a credit union's determination of a member's ability-to-repay a mortgage loan depends on the specific facts and circumstances of that loan.

Simultaneous Loans

A simultaneous loan under section 1026.43(c)(6) is any other mortgage loan or HELOC secured by the same property and made to the same consumer at or before consummation of the covered transaction, or that will cover closing costs of the first covered transaction. The rules require a credit union to consider any simultaneous loans it knows or has reason to know exist for the same dwelling when making the ability-to-repay determination.

For a simultaneous loan that is not a HELOC, the ability-to-repay assessment should include assumed monthly payments on that simultaneous loan, calculated using the guidance listed above for the particular type of simultaneous loan involved. For HELOC simultaneous loans, the ability-to-repay assessment should include assumed monthly payments on the simultaneous loan based on the expected amount of credit drawn at or before consummation of the main loan.

Verifying Information

A credit union must verify a member's employment history, credit history, income or assets only to the extent to which the credit union considers them to determine the member's ability-to-repay. In general, a credit union must use reasonably reliable third-party records to verify any information it uses to evaluate the above factors and must retain those records for three years. A list of sources that a credit union may use to verify the information it relied on to determine a member's ability-to-repay is available in the rule and its commentary.

EXAMPLE

For example, if the member has two jobs but only needs one to demonstrate his or her ability to pay, the credit union would not need to verify the income from the second job. There is detailed information about verifying employment in the regulation for more information.

Qualified Mortgages

A mortgage is deemed in compliance with the ability-to-repay requirements if it meets one of the definitions of a "qualified mortgage." There are six types of qualified mortgages (QMs):

- General Definition QMs
- Government Agency Definition QMs
- Small Creditor QMs

- Balloon Payment QMs
- Seasoned QMs
- Portfolio Loan QMs

Each type of qualified mortgage has its own specific characteristics and features in section 1026.43(e). Any credit union can originate general definition or temporary QMs. Small creditor and balloon-payment QMs can only be originated by credit unions that meet the definition of "small creditor." Qualified mortgages are given certain legal presumptions that they are "good" loans and meet the ability to repay requirements. While the characteristics of the four types of QMs differ, they are similar in that they share features that the bureau feels creates a stable, solid loan. This section will outline some of these elements in principle, but a credit union making a QM determination regarding its loans should consult the rule directly for more technical detail.

General Definition QM

The first category of QMs is the general definition QM. Amendments to this rule moving away from a debt-to-income threshold to a priced based standard became effective October 1, 2022. A general definition QM has the following characteristics:

- **Price based limitation**. Effective October 1, 2022 to meet the general QM definition, a loan must not exceed certain pricing limitations. For most first lien covered loans, the APR cannot exceed the average prime offer rate (APOR) by more than 2.25 percentage points. There are different thresholds for smaller loan amounts, subordinate liens and manufactured homes.
- **Loan term.** The term of the loan may not exceed 30 years. Thus, if the loan's term is 40 years, it will not meet the definition of "qualified mortgage."
- **Points and Fees.** The total points and fees charged may not exceed the threshold set for the size of the loan under the rule. The thresholds differ based on the loan amount. The thresholds are updated annually in the commentary to the rule.
- **Underwriting.** The loan must be underwritten taking into account the monthly payment for mortgage-related obligations using: (1) the maximum interest rate that may apply during the first five years after the date of the first periodic payment; and (2) periodic payments of principal and interest that will repay either the principal balance over the remaining term of the loan as of the date the interest adjusts to the maximum interest rate or the loan amount over the loan term (i.e., underwritten based on a fully amortizing schedule).
- **Income and Debt.** The credit union must consider and verify the consumer's current or reasonably expected income or assets other than the value of the dwelling, as well as the consumer's debt obligations, alimony and child support.
- **Debt-to-Income Ratio.** The credit union must consider the borrower's debt-to-income ratio.

MORE INFORMATION: Calculating the points and fees to make a QM determination is a technical task. Section 1026.32(b)(1) defines what charges are included. Section 1026.43(e)(3)(iii) allows a credit union to return charges in excess of the threshold to the borrower in order to stay under the threshold.

There are certain features which the bureau has deemed especially risky and which can disqualify a mortgage from being a general definition QM. These risky features include:

- **Negative amortization.** This feature may allow the principal balance to increase during the life of the loan.
- **Interest-only payments.** If the loan allows the payment of principal to be deferred, it is not a general definition QM.
- **Balloon payments**. If a balloon payment is due at the end of the loan, it is not a general definition QM, though it may be a balloon payment QM.

Government Agency QMs

Dodd-Frank required various federal agencies that insure or guarantee loans to implement their own definition of "qualified mortgage." The CFPB's temporary QM was designed as a placeholder until those agencies have established their own QM definitions. One category is for loans eligible for purchase by Fannie Mae or Freddie Mac, known as the Government Sponsored Enterprise (GSE) patch. This temporary category expired on October 1, 2022, the mandatory compliance deadline for changes to the general QM. That said, credit unions may not be able to use the GSE patch because of the limitations on the types of loans that GSEs can purchase. As of October 1, 2022, the QM rule recognizes that some loans are QMs by meeting the definition requirements of certain government entities.

MORE INFORMATION: The U.S. Department of Housing and Urban Development (HUD), the Department of Veterans Affairs (VA) and the Rural Housing Service (RHS) have issued final rules defining "qualified mortgage" for loans subject to their jurisdiction. Those rules superseded the temporary agency QM definitions that existed in the old QM rule. The current version of section 1026.43(e)(4) expressly cross references those agency rules.

Small Creditor Definition

A credit union is a "small creditor" if:

- The total assets of the credit union and its affiliates were less than a certain asset threshold at the end of the previous calendar year (a little over $2.2 billion, adjusted annually for inflation in the staff commentary); and
- Together with all affiliates, it originated and sold, transferred or assigned 2,000 or fewer first-lien mortgages that are subject to the ability-to-repay rule during the previous calendar year. Loans that the credit union or its affiliate originate and keep in its portfolio do not count toward the 2,000 loan threshold.

In determining whether it qualifies as a "small creditor" a credit union must only count first lien mortgages and only those mortgage loans that are within the scope of the ATR/QM rule. Thus, a credit union would not count subordinate liens or mortgages outside the scope of the rule, such as HELOCs or reverse mortgages. The rule also requires a credit union to include both those mortgage loans it originated as well as those that its affiliates originated in the previous calendar year.

EXAMPLE

A mortgage loan originated by the credit union's affiliated credit union service organization (CUSO) would count toward the 2,000 loan threshold. Similarly, the credit union's affiliated CUSO would count toward the asset threshold (adjusted annually for inflation).

Small Creditor QM

A small creditor QM must be made by a small creditor. The loan must have a maximum term of 30 years and must not exceed the points and fees threshold in the general definition. The loan also **may not** have the three risky features.

The underwriting requirements for small creditor QMs are somewhat relaxed. As part of the underwriting, the credit union must consider and verify the consumer's income including considering the consumers debt-to-income ratio. The loan must also be underwritten based on a fully amortizing schedule and the maximum interest rate that may apply during the first five years of the loan.

The loan must be held in portfolio and not be subject to a forward commitment. Small creditor QM loses its status if the credit union sells or transfers the loan less than three years after consummation. However, the loan does not lose its status if:

- It is sold to another "small creditor;"

- It is sold pursuant to a supervisory action or agreement; or
- It is transferred as part of a merger or acquisition.

Balloon Payment QMs

A small creditor can also make a balloon-payment QM if it operates in a rural or underserved area. A balloon-payment QM must have a minimum term of 5 years and a maximum term of 30 years. It **must** have a fixed interest rate and periodic payments (other than the balloon payment) that would fully amortize the loan over 30 years or less. It must not exceed the points and fees threshold in the general definition. The loan also **may not** have the three risky features.

In terms of underwriting, for a mortgage to qualify as a Balloon-Payment QM, the credit union is required to:

- Determine that the consumer can make the scheduled periodic payment;
- Consider and verify the consumer's income and assets; and
- Consider the consumer's debt-to-income ratio or residual income.

Similar to a small creditor QM, it also may not be subject to a "forward commitment." The loan loses its status as a QM if it is sold within three years after consummation unless sold to a credit union that is eligible to make Balloon QMs or as part of a supervisory action or a merger or acquisition.

Seasoned QMs

In December 2020, the CFPB created a new category of QMs, the Seasoned QM. A residential mortgage loan is a Seasoned QM if the loan meets certain product restrictions, does not exceed a points-and-fees limit, and satisfies underwriting requirements. This includes:

- The loan is secured by a first-lien;
- The loan is fixed-rate;
- The loan payments are regular and substantially equally;
- There is no negative amortization;
- There is no balloon payment;
- The loan's maturity does not exceed 30 years; and
- The loan is not a high-cost mortgage.

Portfolio Loan QMs

The credit union must also hold the loan in portfolio until the end of the seasoning period, with some exceptions, and the loan must meet certain performance standards at the end of the seasoning period.

Section 101 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, created another category of QM that only applies to depository institutions like credit unions with under $10 billion in assets. For a mortgage loan to qualify as a Portfolio Loan QM, it *may not* have the following features and characteristics:

- Negative amortization
- Interest-only; and
- Points and fees in excess of the limits for QMs in the General Definition.

The following restrictions also apply:

- The loan must be originated and held in portfolio by the insured credit union;
- The credit union must consider and document the consumer's debt, income and assets but no one method of documentation is required; and
- Generally, the loan may not contain a prepayment penalty other than a few limited circumstances described in TILA.

NAFCU NOTE

More on Seasoned QMs can be found in this NAFCU *Compliance Blog* post. Additionally, more on the Portfolio Loan QM can be found in this blog post.

Safe Harbor and Presumption of Compliance

The QM designation is valuable because it creates a legal protection for the credit union regarding the ability-to-repay requirement. The strength of that legal protection depends on whether the loan is considered a "higher-priced covered transaction."

Higher-Priced Covered Transactions

A "higher-priced covered transaction" under section 1026.43 is a separately defined term from an HPML discussed above. A mortgage loan is a higher-priced covered transaction under the ATR/QM rule if the loan's Annual Percentage Rate (APR) exceeds the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set by a specific amount. The amount varies by the type of QM and the priority of the lien. Specifically, for most first lien covered transactions, the APR cannot exceed the APOR by more than 1.5% to receive the safe harbor. Such loans receive a rebuttable presumption of compliance, as opposed to a safe harbor, if the APR exceeds the APOR by 1.5% to 2.25%. There are different thresholds for smaller loan amounts and manufactured homes. A table of the safe harbor thresholds is below.

	General and Temporary QMs	Small Creditor and Balloon-Payment QMs
First Lien	APR Exceeds APOR by 1.5%	APR Exceeds APOR by 3.5%
Subordinate Lien	APR Exceeds APOR by 3.5%	APR Exceeds APOR by 3.5%

Safe Harbor Versus Presumption

A qualified mortgage that is not a higher-priced covered transaction has a "safe harbor" legal protection under the rule. Such a mortgage is deemed to have complied with the ability-to-repay requirements. Stated differently, a court will presume conclusively that the credit union complied with the ability-to-repay requirements.

A qualified mortgage that is a higher-priced covered transaction is presumed (but not conclusively) to comply with the ability-to-repay requirements. A court will presume that the credit union complied with the ability-to-repay requirements, but the **borrower may rebut the presumption**. In such a case, the borrower must show that the credit union did not make a reasonable and good faith determination of the borrower's repayment ability at the time of consummation. Generally, if making a rebuttal, the borrower would need to show that he did not have enough residual income left to meet living expenses after paying the mortgage and other debts.

Record Retention

Section 1026.25(c)(3) of Regulation Z requires that credit unions retain records demonstrating compliance with the ability-to-repay and qualified mortgage provisions for three years.

LOAN ORIGINATOR RULES

Following the subprime mortgage crises, Dodd-Frank established specific requirements and prohibitions for individuals and entities engaged in the business of originating loans. These rules are implemented in section 1026.36 of Regulation Z.

RESEARCH TIP: Note that the scope and requirements of the loan originator rules in Regulation Z differs from the scope and requirements of the SAFE Act and its implementing regulations found in the CFPB's Regulation G, 12 CFR Part 1007, or Regulation H, 12 CFR Part 1008.

Definitional Scope

Regulation Z's loan originator rules generally apply to individuals and entities who meet the specific definitions. Generally, a "loan originator" includes individuals and entities that perform loan origination activities for compensation, such as taking an application, offering credit terms, negotiating credit terms on behalf of a consumer, obtaining an extension of credit for a consumer or referring a consumer to a loan originator or credit union.

A "loan originator" is either an "individual loan originator" or a "loan originator organization." An "individual loan originator" is a natural person, such as a credit union employee who performs loan origination activities. A "loan originator organization" is generally a loan originator that is not a natural person, such as a credit union.

The rule specifically excludes some persons from being a "loan originator," including certain real estate brokers, seller financers and loan servicers. Further, each provision of the rule contains its own adjustments to the definition of loan originators that fall within the individual scope of each provision.

RESEARCH TIP: The definition of a "loan originator" is very complex and requires a detailed analysis of the facts and circumstances of each individual's job duties and participation in a loan transaction. The commentary provides additional information to help in this analysis.

Transactions within the scope of the rule include almost all closed-end consumer credit transactions secured by a dwelling (including any real property attached to the dwelling). Generally, the applicability of the loan originator rules is not limited to first liens or to loans on primary residences. Thus, manufactured homes, boats, trailers and other loans that may be secured by personal property and that are used as a dwelling would fall under the scope of the loan originator rules. There is a general exception for HELOCs covered by the requirements of section 1026.40. The individual requirements of the rule also have individual scopes that exclude or include specific types of transactions.

Loan Originator Compensation

The loan originator compensation rules in section 1026.36(d) apply to closed-end mortgage transactions, excluding time shares. The provision:

- Prohibits a loan originator's compensation from being based on the terms of the transaction or a proxy for a transaction term;
- Permits certain methods of compensating loan originators using bonuses, retirement plans and other compensation plans that are based on mortgage-related profits; and
- Prohibits loan originators in a transaction from being compensated by both the consumer and another person, such as a credit union.

The rule defines compensation broadly and means salaries, commissions, and any financial or similar incentive. It includes any payment that the loan originator retains, regardless of how the fee is labeled.

RESEARCH TIP: The application of the compensation provisions of section 1026.36 is very fact and context specific. The CFPB Small Entity Compliance Guide and the staff commentary offer more detailed analysis and provide illustrative examples that will help determine how these compensation provisions apply to an individual transaction.

Compensation Based on a Term of the Transaction

A "term of a transaction" is "any right or obligation of the parties to a credit transaction." This means, for example, that a mortgage broker cannot receive compensation based on the interest rate of a loan, or based on the fact that the loan officer steered a consumer to purchase required title insurance from an affiliate of the broker, since the consumer is obligated to pay interest and for required title insurance in connection with the loan, and both items are therefore a term of the transaction.

The rule prohibits compensation based on a "proxy" for a term of a transaction. The rule also further clarifies the definition of a proxy to focus on whether: 1) the factor consistently varies with a transaction term over a significant number of transactions; and 2) the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating the transaction.

Additionally, the rule generally prohibits loan originator compensation from being reduced to offset the cost of a change in transaction terms, often called a "pricing concession." However, loan originators may reduce their compensation to cover certain unexpected increases in estimated settlement costs.

Permissible Methods of Compensation

While the rule generally prohibits loan originator compensation based upon the profitability of a transaction or a pool of transactions, it permits certain bonuses and retirement and profit-sharing plans to be based on the terms of multiple loan originators' transactions. Specifically, the funds can be used for:

- Contributions to or benefits under certain designated tax-advantaged retirement plans, such as 401(k) plans and certain pension plans;
- Bonuses and other types of non-deferred profits-based compensation if the individual loan originator originated ten or fewer mortgage transactions during the preceding 12 months; and
- Bonuses and other types of non-deferred profits-based compensation that do not exceed 10 percent of the individual loan originator's total compensation.

MORE INFORMATION: Remember that NCUA also set limitations on who can receive compensation in connection with loans. See Section 1 of this chapter for more details on these rules.

Prohibition Against Dual Compensation

Where a loan originator receives compensation directly from a consumer in connection with a mortgage loan, no loan originator may receive compensation from another person in connection with the same transaction. The rule, however, provides an exception to allow mortgage brokers to pay their employee or contractor commissions, although the commissions cannot be based on the terms of the loans that they originate.

Loan Originator Qualifications and Training

Paragraph 1026.36(f) of Regulation Z contain qualifications and training requirements for a credit union's mortgage loan originators.

Qualifications and Screening Standards

Section 1026.36(f) sets forth qualification and screening requirements that the credit union (as loan originator organization) must ensure are met by its individual loan originators, and the organization itself. These qualification requirements include:

1. **Legal Existence and Foreign Qualification.** The credit union is required to comply with applicable state law requirements governing the legal existence and foreign qualification of the credit union. This refers to the requirements that govern the legal creation of the credit union and the authority of the credit union to transact business in a state. This includes requirements for incorporation or other types of formations and for maintaining an agent for service of process.

2. **License or Registration Requirement.** The credit union is required to ensure its individual loan originators are in compliance with SAFE Act licensing and registration requirements.

MORE INFORMATION: The SAFE Act requires individuals fitting its definition of a mortgage loan originator to obtain a unique identifier form and register with the Nationwide Mortgage Licensing System & Registry (NMLSR). The CFPB's Regulation G implements the requirements for federal registration, which typically applies to employees of depository institutions. Regulation H implements the SAFE Act for loan originators that are state-licensed. In 2018, Congress made amendments to the SAFE Act to provide a 120-day transitional license for an individual loan originator making a change in jobs.

3. **Requirement to Collect Background Information on Loan Originators Not Licensed Under State SAFE Act.** If an individual loan originator is not required to be licensed under Regulation H or a state SAFE Act implementing law, a credit union must obtain the following items regarding the loan originator:

- A criminal background check;
- A credit report; and
- Information about any administrative, civil or criminal findings by any government jurisdiction.

- A credit report may be obtained directly from a consumer reporting agency or through a commercial service. A criminal background check and information about any administrative, civil or criminal determinations are both required for federal registration under Regulation G and can be obtained from the NMLSR to meet the rule's requirements.

4. **Determination as to Whether Loan Originator Not Needing a License Meets Qualification Standards**. Finally, where loan originators are not required to be licensed, credit unions must review the background information gathered, along with any other reasonably available information, and assess whether an individual loan originator has shown sufficient **financial responsibility, character** and **general fitness** to demonstrate that they will operate in an honest, fair and efficient manner.

   Generally, no single factor dictates a determination that the individual does not meet the standards for financial responsibility, character or general fitness; rather, all factors should be considered and a determination made on a balancing scale. The absence of significant adverse information can be enough to make the determination. However, Regulation Z does provide a list of crimes that would serve as automatic disqualifiers for individual loan originators. An individual loan originator should not have been convicted, pled guilty or pled no contest to a felony involving fraud, dishonesty, a breach of trust or money laundering at any time, or any other felony within the preceding seven years. Establishing and following written procedures for determining whether individuals meet the screening standards generally meets this requirement.

MORE INFORMATION: Regulation Z's list expands on the SAFE Act's general prohibition from employing individuals convicted of offenses involving dishonesty, money laundering or breach of trust. The Federal Credit Union Act contains a similar prohibition described in 12 USC § 1785(d).

There are specific provisions regarding loan originators hiring prior to 2014 when the requirement was established. Further, if the credit union discovers reliable information indicating that the individual loan originator likely no longer meets the required standards in the rule, it may need to reassess its determination regardless of the hire date or previous screening.

Training Requirement

Credit unions are required to provide periodic training to employee-loan originators who are not licensed under the SAFE Act, regardless of when they were hired. Again, this would apply to most credit unions who are loan originator organizations, as the law only requires depository institution employees to be registered and not licensed. The training must be "periodic" and it must cover federal and state law requirements that apply to the individual's loan origination activities. In other words, the training must take into consideration the particular responsibilities of the individual loan originator and the nature and complexity of the mortgage loans with which the individual loan originator works.

The requirements are fairly flexible and allow the training to be provided by the credit union itself, or any third party. The training may be in person or online. The staff commentary provides examples of training that would meet this requirement, including training approved by the NMLSR to meet the continuing education requirement for licensed loan originators and training approved by a federal, state or other government agency, to the extent that the training covers the types of loans the individual loan originator originates and the applicable federal and state laws that apply to the loan originator.

NMLSR ID Disclosure

As previously referenced, the SAFE Act requires mortgage loan originators to register with the NMLSR and obtain an NMLSR unique identifier, referred to as the NMLSR ID. The NMLSR ID facilitates electronic tracking and uniform identification of loan originators and provides public access to the employment history of, and the publicly adjudicated disciplinary and enforcement actions against, loan originators.

Section 1026.36(g) of the rule requires credit unions to disclose the name and NMLSR ID of both the individual loan originator and the loan originator organization on the credit application, the note or loan contract and the security instrument. The disclosures are only required once on each required document, not on every page.

MORE INFORMATION: There are also requirements to disclose this information on the Loan Estimate and Closing Disclosure. These requirements are found in the TRID rules and discussed in Section 7 of this chapter.

If more than one loan originator works on a loan transaction, the name and NMLSR ID of the individual loan originator with **primary responsibility for the transaction at the time the loan document is issued** must be included. The credit union has flexibility to establish a reasonable, written policy that sets forth how it will determine which individual loan originator has primary responsibility for a transaction. If the individual loan originator with primary responsibility for a transaction changes, the credit union does not need to reissue previously completed documents merely to update the name and NMLSR ID. Going forward, the credit union would include on loan documents the information about the individual who now has primary responsibility and would not include the information about the individual who formerly had primary responsibility.

Prohibited Practices

The loan originator rules prohibit certain practices in loan origination including steering consumers to loans that offer the best compensation for the loan originator, including certain contractual provisions, or financing certain kinds of charges. There are exceptions to these prohibitions and more detail in section 1026.36.

Mandatory Arbitration or Waivers of Certain Consumer Rights

Section 1026.36(h) of Regulation Z prohibits credit unions from including contractual or agreement terms that require mandatory arbitration or any other non-judicial procedure to resolve disputes arising out of closed-end consumer credit transactions secured by a dwelling. These prohibitions do not necessarily rule out the use of arbitration or non-judicial procedures altogether. The credit union and consumer could still agree, *after a dispute or claim arises*, to settle, or use arbitration or other non-judicial procedures to resolve the dispute or claim.

In addition, the rule prohibits applying or interpreting a contract or other agreement to bar a consumer from bringing a claim in court under any provision of law for damages or other relief in connection with an alleged violation of any federal law. While HELOCs subject to section 1026.40 are generally excepted from the requirements of the loan originator rules, these prohibitions apply to HELOCs secured by a consumer's principal dwelling.

Financing Single Premium Credit Insurance

The rule also restricts credit unions from financing certain credit insurance premiums or fees. Section 1026.36(i) provides that a credit union may not finance, directly or indirectly, any premiums or fees for credit insurance in connection with a closed-end consumer credit transaction secured by a dwelling (except for certain time-share plans) or for a HELOC secured by the consumer's principal dwelling. Consumers can pay credit insurance that is calculated on a monthly basis, if it is calculated in accordance with the rule.

Credit insurance refers to credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract. The rule specifically excludes credit unemployment insurance from the definition of "credit insurance" if certain requirements are met.

A premium or fee for credit insurance is "financed" if the credit union provides the consumer the right to defer payment of the credit insurance premium or fee beyond the monthly period in which the premium or fee is due. For single-premium credit insurance, a credit union violates the prohibition by adding the credit insurance premium or fee to the amount owed at closing.

Recordkeeping Requirements

The recordkeeping requirements for the loan originator rule can be located in section 1026.25. What records must be maintained is dependent on whether the credit union is considered a loan originator organization for purposes of the compensation provisions.

The rule does not specify which records must be kept. Instead, it provides examples of records that may be kept and what would be deemed sufficient evidence for purposes of recordkeeping.
Credit unions must keep records related to the requirements for loan originator compensation for three years after the date of payment or receipt of compensation. Also, credit unions must retain records for three years after each receipt or payment, even if multiple compensation payments relate to a single transaction.

CHAPTER 3 — LENDING

SECTION 9 — SPECIAL MORTGAGE RULES – MORTGAGE SERVICING

OVERVIEW

After a mortgage loan is originated, there are many ongoing tasks and other maintenance that must be done regarding that loan. It is not uncommon for the lender who made the loan to transfer the servicing of the loan to a mortgage servicer. A mortgage servicer may even engage a sub-servicer to perform tasks regarding the loan on their behalf. Most of the rules for how the loan will operate are determined by the terms of the loan agreement and the security instrument. However, there are specific federal regulations covering some mortgage servicing issues.

The requirements for servicing mortgage loans are found in both Regulation X (12 CFR Part 1024) and Regulation Z (12 CFR Part 1026). Because the mortgage servicing requirements are found in different subparts of multiple regulations, it is important to understand which loans are subject to each mortgage servicing requirement. Some servicers are exempt from these requirements based on the size of the mortgage servicer. While this exception is defined in Regulation Z, it applies to requirements in both regulations. The exemption, referred to as the small servicer exemption, is detailed at the end of this section.

RESEARCH TIP: For a more detailed view of mortgage servicing, take a look at the CFPB's current version of its Small Entity Compliance Guide and Mortgage Servicing Examination Manual.

GENERAL SERVICING POLICIES, PROCEDURES AND REQUIREMENTS

Servicers are required to establish policies and procedures reasonably designed to achieve objectives and standards specified in the rule. This requirement is found in section 1024.38 of Regulation X. It applies to all federally related mortgage loans, except for HELOCs and open-end lines of credit, reverse mortgage transactions and loans for which the servicer is a qualified lender under the Farm Credit Act of 1971. This requirement is subject to the small servicer exemption discussed at the end of this section.

MORE INFORMATION: For discussion on RESPA's coverage, review Section 6 of this chapter.

Objectives of Mortgage Servicing Policies and Procedures

Under section 1024.38, servicers are required to establish policies and procedures reasonably designed to achieve the following five objectives:

- Accessing and providing timely and accurate information, including requirements to have policies regarding potential and confirmed successors in interest as defined in section 1026.2(a)(27) of Regulation Z and section 1024.31 of Regulation X;
- Properly evaluating loss mitigation applications;
- Facilitating oversight of, and compliance by, service providers;
- Facilitating transfer of information during servicing transfers; and
- Informing members of the written error resolution and information request procedures.

RESEARCH TIP: The CFPB issued Bulletin 2014-01 for residential mortgage servicers and sub-servicers to use in evaluating the potential risks to members that may occur when transferring residential mortgage servicing rights.

The rule also sets specific requirements and standards for record retention and servicing file creation.

The reasonableness of a servicer's policies and procedures takes into account the size, scope and nature of the servicer's operations. Therefore, a servicer has flexibility to set policies and procedures so long as the policies and procedures are reasonably designed to meet the five objectives above.

Successors in Interest

Certain servicing requirements apply to both the member and their successors in interest. A "successor in interest" is defined in a highly technical way, drawing upon legal terms of art that have particular meaning under various states' property, estate, probate and family law provisions. Generally, under section 1024.31, a successor in interest is a person who is transferred "an ownership interest in a dwelling securing a closed-end consumer credit transaction," if that transfer occurs under specific circumstances. These circumstances include, but are not limited to: a transfer due to the death of the member; where a member's spouse or children become owners of the property; a transfer resulting from a divorce or similar agreement where a spouse becomes an owner of the property; a transfer to a living trust; and transfers by operation of law upon the death of certain owners. A successor in interest becomes "confirmed" when the credit union has confirmed the person's identity and ownership interest in the property.

NAFCU NOTE

This NAFCU *Compliance Monitor* article on the successors in interest rule is a helpful primer on the requirements (member only).

Record Retention

Under section 1024.38(c)(1), servicers are required to retain records documenting action on a mortgage loan account until one year after the mortgage loan is discharged or servicing is transferred. This does not mean that servicers need to keep actual paper copies of documents. Instead, servicers can retain the records using any method that accurately reproduces them and that ensures the records can be easily accessed. These methods can include computer programs and contractual rights to access records possessed by another entity.

Servicing File Creation

Regulation X requires servicers to maintain certain documents and data on each mortgage loan account it services in a manner that allows the data to be compiled within five days. The servicing file must include, among other things, all credits and debits on the account, the history of any escrow and suspense accounts, a copy of the security instrument establishing the mortgage lien, any servicing notes detailing communications with the member, copies of documents and information submitted as part of loss mitigation or error resolution requests and system records regarding the mortgage loan, such as the loan terms and loss mitigation evaluation information.

The five-day compilation requirement does not provide members with an independent right to access information in the servicing file. Instead, when a member makes a written request for their servicing file, servicers must follow the procedures for information requests discussed later in this section.

ADJUSTABLE-RATE MORTGAGE NOTICES

Under Regulation Z, initial and ongoing disclosures are required when an interest rate changes on an adjustable-rate mortgage (ARM). This requirement is found in section 1026.20(c)-(d) and applies to closed-end consumer credit transactions secured by a consumer's principal dwelling in which the annual percentage rate may increase after consummation. The requirement applies to creditors, assignees and servicers, though the parties may negotiate which of them will send the notice. ARMs with a term of one year or less are exempt from the disclosure requirements. ARM notices are also required to be provided to confirmed successors in interest who have executed an acknowledgement under section 1024.32(c)(1)(iv) of Regulation X.

Initial Rate Adjustment Notices

The initial interest rate adjustment notice is only required the first time the interest rate changes. Section 1026.20(d) specifies that this notice must be provided to the member between 210 and 240 days before the due date of the first payment at the new rate. Estimated information may be used to provide this notice using the index as reported within 15 business days prior to the disclosure. Initial rate adjustment notices may be delivered in the same envelope as other notices but must be a separate document.

Ongoing Interest Rate Adjustment Notices

Under section 1026.20(c), an ongoing interest rate adjustment notice must be provided every time an interest rate adjustment – after the initial adjustment – results in a change to the payment amount. These notices must be sent at least 60 but no more than 120 days before the first payment at the new rate is due. Exact information must be used in calculating ongoing notices. The notice may be mailed with and on the same document as other notices. However, the interest rate notice must be segregated from the other information in the document.

There are separate timing requirements for two specific categories of ARMs:

- ARMs that adjust every sixty days or less; and
- ARMs originated before January 10, 2015, with a look-back period of less than 45 days

In these two cases, interest rate adjustment disclosures must be sent at least 25 days but no more than 120 days before the first payment at the adjusted level is due.

NAFCU NOTE

This NAFCU *Compliance Blog* post on ARM notices is a great summary and reference tool for the rules discussed above.

Form and Content of ARM Notices

Regulation Z contains specific content requirements for the ARM notices, including information about new rates, how they are determined and the effective date of adjustments. ARM disclosures must be provided in the form of a table, as shown in the model forms located in Regulation Z's Appendix H.

The notices must also state any alternatives to paying the new rate and provide housing counseling information. The housing counseling information must include either the CFPB's or HUD's list of homeownership counselors, the HUD toll-free number for accessing the list of homeownership counselors and the CFPB website listing contact information for state housing finance authorities.

PROMPT CREDITING

Section 1026.36(c) of Regulation Z requires credit unions that are mortgage servicers to follow particular procedures for handling different types of payments. These prompt crediting rules apply to closed-end consumer transactions that are secured by a principal dwelling. Regulation Z describes three kinds of payments: periodic payments, partial payments and non-conforming payments.

Periodic Payments

A "periodic payment" is defined as one that includes the amount necessary to pay principal, interest and any applicable escrow. This means that even if a member fails to include a past due late fee, a payment can still be a "periodic payment." The general rule is that credit unions must credit "periodic payments" as of the day the payment was received. The staff commentary clarifies that the date of receipt means the day the payment reaches the credit union, not when the funds are actually collected. However, servicers may delay crediting a periodic payment so long as the delay does not result in negative action against the member, such as a late fee or negative reporting to credit bureaus.

Partial Payments

A "partial payment" under section 1026.36(c)(1)(ii) is any payment that is insufficient to cover principal, interest and any applicable escrow. If a member makes a partial payment, the credit union has a few options for handling the payment under the servicing rules. The credit union can credit the payment upon receipt, return the payment to the member or place the partial payment into a suspense account until the funds sufficient to cover a periodic payment accumulate. Once enough funds accumulate, the credit union must apply the periodic payment to the loan. Servicers using suspense accounts must disclose on the member's periodic statement the amount of funds the credit union is holding in the suspense account, assuming that the servicer is not exempt from the periodic statement requirement.

Non-Conforming Payments

A "non-conforming payment" is a payment that does not meet reasonable requirements that the servicer specified to the member in advance and in writing. For example, a payment would be "non-conforming" if the credit union required that members send payments to a particular address and the member mails the payment elsewhere. Where the amount of a payment qualifies as a periodic payment, but the member makes a non-conforming payment, the credit union must credit the payment within five days of receipt.

Prohibition Against Pyramiding Late Fees

Servicers are prohibited from "pyramiding" late fees. Pyramiding of late fees occurs when a member pays the current amount due without the prior month's late fee and the payment is applied to the late fee first, leaving an overdue balance on the current month's payment and resulting in another late fee. In other words, if a member makes a periodic payment on time without paying a past due late fee, the credit union may not charge an additional late fee.

PERIODIC STATEMENTS

Section 1026.41 of Regulation Z requires that mortgage servicers provide a statement each billing cycle for all closed-end credit transactions secured by a dwelling, except for reverse mortgages, timeshare loans and certain charged-off loans. Creditors, assignees and servicers who currently own the mortgage or the servicing rights are responsible for sending periodic statements. Small servicers are exempt from sending periodic statements.

A coupon book can be provided instead of periodic statements for certain fixed-rate loans.
Periodic statements must be specially modified and sent to members in bankruptcy, unless one of several technical requirements are met. Periodic statements must also be provided to certain non-borrower "confirmed successors in interest."

NAFCU NOTE

The 2016 mortgage servicing rules added the exceptions for members in bankruptcy or who have made cease contact requests under the FDCPA. This NAFCU *Compliance Monitor* article is a helpful resource in understanding these technical exceptions (member-only).

Timing of Periodic Statements

Section 1026.41(b) requires a periodic statement be sent each billing cycle. This means that the frequency of the payments due will determine how often a periodic statement must be sent, i.e., monthly or quarterly. The periodic statement must be sent within a "reasonably prompt" time after the prior payment due date or the end of any courtesy period. The staff commentary states that this means sending the periodic statements within four days of the close of the previous billing cycle's courtesy period, the time in which the creditor does not impose a late fee past the due date. Creditors no longer have to send a periodic statement when the loan is transferred to another servicer, the loan is fully paid by either refinance or sale of the home, or the property is sold at a foreclosure sale.

Format and Content of Periodic Statements

There are detailed content requirements in Regulation Z. There are also specific formatting requirements for grouping and presenting information on periodic statements. For example, the due date, amount of the potential late fee and amount due must be grouped together and placed at the top of the first page of the statement. Also, the required information must be "clear and conspicuous," meaning in a form that is reasonably understandable. Model forms H-30(A)-(D) in Appendix H of Regulation Z contain model periodic statements that servicers should reference when reviewing their own forms.

While this rule does not allow members to opt out of receiving statements, members may elect to receive periodic statements electronically in a format that can be printed or downloaded.

Using Coupon Books Instead of Periodic Statements

Servicers may use coupon books instead of periodic statements for fixed rate loans. Each coupon must include the amount due, the amount of any late fees, the date late fees will be charged and the due date. The coupon book itself must also include:

- The contact information for homeownership counseling including HUD's toll-free telephone number;
- The principal balance as of the beginning of the time period covered by the coupon book;
- A statement regarding how a member can obtain information such as an explanation of the amount due or a past payment breakdown;
- The current interest rate;
- Any prepayment penalty; and
- Contact information for how members can receive more information about their loans.

The staff commentary clarifies that the information listed above simply needs to be somewhere in the coupon book such as the front or back cover.

RESPONDING TO QUALIFIED WRITTEN REQUESTS

Regulation X defines a "qualified written request" as written correspondence from the member to the servicer that enables the servicer to identify the member and their mortgage account and either asserts an error regarding the account or requests information regarding the servicing of the account.

A qualified written request that asserts an error is a notice of error and triggers error resolution procedures under section 1024.35 of Regulation X. A qualified written request that requests information regarding the "servicing" of the account triggers the response procedures in section 1024.36 of Regulation X. Both requirements apply to any federally related mortgage loan, except for open-end lines of credit (HELOCs).

Error Resolution

Section 1024.35 of Regulation X establishes requirements for responding to a written notice of error from a member.

What is an "Error"?

Section 1024.35(b)(11) explains that an "error" must be "relat[ed] to the servicing of a borrower's mortgage loan" and may include:

- Failure to accept a payment that conforms to the servicer's written requirements;

- Failure to apply an accepted payment to principal, interest, escrow or other charges under the terms of the loan and applicable law;
- Failure to credit a payment to a member's mortgage loan as of the date of receipt;
- Failure to pay taxes, insurance premiums or other changes or to refund an escrow account balance;
- Failure to provide an accurate payoff balance amount upon a member's request;
- Failure to provide accurate information to the member regarding loss mitigation options and foreclosure;
- Failure to transfer accurately and timely information relating to the transfer of servicing of a member's mortgage loan to another servicer;
- Imposition of a fee or charge that the servicer lacks a reasonable basis to impose;
- Moving for foreclosure judgment or order of sale or conducting a foreclosure sale in violation of RESPA loss mitigation procedures.

This list is not exhaustive, so servicers should be mindful of which errors would fall under the definition of "servicing" that is set forth in section 1024.2(b). Servicing means receiving any scheduled periodic payments from the borrower under the terms of any mortgage loan, including amounts for escrow accounts and making the payments to the owner of the loan or other third parties.

MORE INFORMATION: In addition to a description of what an error is, the staff commentary gives examples of what is not considered an error under this rule, including: errors relating to mortgage loan origination and underwriting, the decision to sell or assign a mortgage or the securitization of a mortgage.

Valid Written Notice of Error

A written notice only triggers the error resolution requirements if it is a valid written notice of error under the rule. The written notice must include the member's name, information that allows the servicer to identify the member's mortgage loan account and the error that the member believes occurred. A notice written on a payment coupon or similar form is not considered a notice of error. The staff commentary to section 1024.35(c) clarifies that servicers may establish an exclusive address that members must use to assert an error provided that members are provided notice of this address. Servicers may also establish an internet-based process for receiving notices of error.

Error Resolution Procedures

Under section 1024.35(d), servicers must acknowledge the notice of error within five days. Depending on the alleged error, the servicer may have 30 to 45 days to either correct the error and notify the member in writing that the error was corrected or investigate and notify the member that no error occurred. The timelines for acknowledging the notice of error and resolving the error do not include Saturdays, Sundays or legal public holidays.

Exceptions

The requirements for responding to errors do not apply to duplicative notices of error or notices of error for accounts where the servicing was transferred over one year ago.

A notice of error is duplicative if it is substantially similar to a previous communication and the credit union has already complied with the response regulations. A notice of error or information request is not duplicative when it contains "new and material information," meaning information the credit union did not review in the previous investigation and is reasonably likely to change the credit union's determination.

If the notice of error was delivered to the servicer more than one year after servicing of the mortgage loan was transferred to a transferee servicer or one year after the mortgage loan was paid in full or discharged, the procedures do not apply.

If the credit union determines that an exception applies, the credit union must notify the member in writing no later than five days (excluding legal public holidays, Saturdays and Sundays) after making the determination.

Information Requests

Credit unions must follow requirements for responding to any written request from a member relating to the "servicing" of the member's mortgage loan. The requirements, located in section 1024.36 of Regulation X, are similar in many ways to the error resolution rules. This requirement also applies to any federally related mortgage loan, except for open-end lines of credit (HELOCs).

Valid Written Requests for Information

Under section 1024.36(a), the written request must include the member's name, information that allows the credit union to identify the member's mortgage account and information the member is requesting. If a servicer receives a written request for information from a non-borrower that indicates the person may be a potential successor in interest to the property, and the request includes the name of the member/borrower and identifying information for the account, the servicer must provide the non-borrower with a written description of the documents needed to confirm the person as a successor in interest to the property. If insufficient information is provided in the written request from the non-borrower to identify the applicable account, the servicer may respond by including examples of documents needed to establish the applicable account and the person's status as a successor in interest. The servicer can establish an address for receipt of these requests.

A notice written on a payment coupon or similar form is also not considered an information request. As with notifications of errors, section 1024.36(b) permits a servicer to designate, by written notice, an address that a member must use to submit an information request. If a servicer designates a specific address for receiving information requests, a servicer shall designate the same address for receiving notices of error pursuant to section 1024.35(c).

Request Response Procedures

Servicers must acknowledge the request for information within five days. As with the error resolution process, servicers may have 30 to 45 days to provide the information or to conduct a reasonable search for the information. If the information is not available, the servicer must notify the member in writing and explain why the information is unavailable within this 45-day time limit. There is a shorter time frame – within ten days of receiving the request for information – if the request seeks the identity and contact information of the owner or assignee of a mortgage loan. For the purpose of calculating when a response or acknowledgment is due, section 1024.36(d)(2) excludes legal public holidays, Saturdays and Sundays.

Exceptions

A credit union is not required to respond to an overly broad or unduly burdensome request for information. This could include a request for an unreasonable volume of documents or which would incur unreasonable costs in light of the circumstances. If a diligent credit union could not respond to the request without exceeding the regulatory time limit for responding to the request, the procedures are also not required. The servicer must still notify the member in writing no later than five days (excluding legal public holidays, Saturdays and Sundays) after determining that an exception applies.

Distinguishing Between Information Requests and Error Notices

Some members may describe their communication as a request for information when their letter actually details an error or vice versa. Also, some writings may be both a request for information and error notice. Servicers should not rely solely on the member's description to determine how to categorize the member's submission. Instead, the credit union should evaluate "whether the letter fulfills the substantive requirements of a notice of error, information request, or both."

ESCROW ACCOUNTS

If a credit union establishes an escrow account for a federally related mortgage loan, it must follow a series of RESPA-mandated servicing requirements under section 1024.17. It is important to note that RESPA does not require a credit union to establish an escrow account for taxes and insurance. However, if a credit union does so, it must service the account in accordance with the requirements in Regulation X.

Escrow Account Analysis

Before establishing an escrow account and at the completion of the escrow account computation year, a servicer must conduct an analysis to determine the periodic payments and the amount to be deposited. Under Regulation X, the amount of the member's escrow payment depends on the amount of the charges, such as taxes and insurance, that will be disbursed within the escrow account computational year. This computational year is generally a 12-month period beginning with the initial payment into the escrow account by the member.

To estimate escrow disbursements for an escrow analysis, the servicer should use the actual charge for an escrow item in the next computation year if it is known. Otherwise, the servicer may base the estimate on the previous year's charge or the previous year's charge modified by the most recent year's change in the national Consumer Price Index for all urban consumers (CPI, all items). The servicer should use an escrow disbursement date that is on or before the deadline to avoid a penalty and may make annual lump-sum payments to take advantage of a discount. The servicer must pay escrow disbursements by the disbursement date as long as the member is not more than 30 days overdue.

When the account is first established, the servicer may also require an initial deposit to pay the charges that accrue before the date of the initial escrow payment. The member's monthly escrow payment must be one-twelfth of the total annual escrow payments that the servicer reasonably anticipates paying from the account in that computational year. In addition, the servicer may add an "escrow cushion" amount of no greater than one-sixth of the estimated total annual payments from the account.

Shortages, Surpluses and Deficiency Requirements

When conducting subsequent escrow analyses at the completion of an escrow account computational year, a servicer may determine that there is a shortage, surplus or deficiency. RESPA defines an escrow shortage as "an amount by which a current escrow account balance falls short of the target balance at the time of escrow analysis." An escrow deficiency is defined as "the amount of a negative balance in an escrow account."

If the escrow account analysis discloses a surplus, the servicer must, within 30 days from the date of the analysis, refund the surplus to the member if the surplus is greater than or equal to $50. If the surplus is less than $50, the servicer may refund such amount to the member or credit such amount against the next year's escrow payments. These provisions apply as long as the member's mortgage payment is current at the time of the escrow account analysis.

If the escrow account analysis discloses a shortage of less than one month's escrow payment, then the servicer has three possible courses of action:

- The servicer may allow the shortage to exist and do nothing to change it;
- The servicer may require the member to repay the shortage amount within 30 days; or
- The servicer may require the member to repay the shortage amount in equal monthly payments over at least a 12-month period.

If the shortage is more than or equal to one month's escrow payment, then the servicer has two possible courses of action:

- The servicer may allow the shortage to exist and do nothing to change it; or
- The servicer may require the member to repay the shortage in equal monthly payments over at least a 12-month period.

If the escrow account analysis discloses a deficiency, then the servicer may require the member to pay additional monthly deposits to the account to eliminate the deficiency. If the escrow account analysis discloses a deficiency that is less than one month's escrow account payment, then the servicer may:

- Allow the deficiency to exist and do nothing to change it;
- Require the member to repay the deficiency within 30 days; or
- Require the member to repay the deficiency in two or more equal monthly payments.

If the deficiency is greater than or equal to one month's escrow payment, then the servicer:

- May allow the deficiency to exist and do nothing to change it; or
- Require the member to repay the deficiency in two or more equal monthly payments.

The provisions about surpluses and deficiencies apply as long as the member's mortgage payment is current at the time of the escrow account analysis. A servicer must notify the member at least once during the escrow account computation year if a shortage or deficiency exists in the account. This notice may be part of the annual escrow account statement.

Initial Escrow Account Statement

When establishing an escrow account at settlement, the servicer must submit an initial escrow account statement to the member at settlement or within 45 calendar days of settlement for escrow accounts that are established as a condition of the loan. For escrow accounts established post-settlement, the initial escrow account statement must be provided within 45 calendar days of the account's creation.

The initial escrow account statement must include: the amount of the member' monthly mortgage payment; the portion going to escrow; an itemized estimate of taxes, insurance premiums and other charges; the anticipated disbursement dates of those charges; the amount of the cushion; and a trial running balance.

Annual Escrow Account Statement

A servicer must provide the member with an annual statement for each escrow account within 30 days of the completion of the computation year. The servicer must also submit to the member the previous year's projection or initial escrow account statement. The servicer must conduct an escrow account analysis before submitting an annual escrow account statement to the member. The annual escrow account statements must contain:

- The account history;
- Projections for the next year;
- Current monthly mortgage payment and portion going to escrow;
- Amount of past year's monthly mortgage payment and portion that went into the escrow account;
- Total amount paid into the escrow account during the past computation year;
- Amount paid from the escrow account for taxes, insurance premiums and other charges during the same period;
- Balance at the end of the period;
- Explanation of how any surplus, shortage or deficiency is being handled; and
- The reasons why the estimated low monthly balance was not reached, if applicable.

It should be noted that Regulation X exempts servicers from the annual escrow statement requirement if, at the time the escrow account analysis is performed, the member is more than 30 days overdue, the servicer has brought an action for foreclosure or the member is in bankruptcy proceedings.

Short-Year Statements

Short-year statements can be issued to end the escrow account computation year and establish the beginning date of the new computation year. Short-year statements may be provided upon the transfer of servicing and are required upon loan payoff. The statement is due to the member within 60 days from the end of the short year.

Escrow Closing Notice

Section 1026.20(e) of Regulation Z requires creditors or servicers of closed-end consumer loans secured by a first lien on real property or a dwelling to provide an Escrow Closing Notice before cancelling an escrow account. The notice is designed to inform members that their escrow account is closing, why and which items the member will now become responsible for paying directly. There is an exception for reverse mortgages, escrow accounts established due to default and escrow account cancellations in connection with the termination of the underlying debt. When the member requests cancellation of the escrow account relating to a covered loan, the notice is generally required.

RESEARCH TIP: The staff commentary to the escrow closing notice requirement clarifies that "real property" includes vacant and unimproved land. Also, "dwelling" is broadly defined to include residential structures with one to four units when used as a residence whether or not attached to land, including mobile homes and trailers.

The Escrow Cancellation Notice has many technical requirements regarding both its content and its format. Model Form H-29 illustrates the rule's requirements.

The timing requirement for the notice differs depending on whether the member or the credit union cancels the escrow account. When the member requests cancellation of an escrow account for a covered loan, the credit union must provide the Escrow Closing Notice no later than three business days before the escrow account is closed. When the credit union closes a covered escrow account, the Escrow Closing Notice must be provided at least 30 business days before the account is closed.

FORCE-PLACED INSURANCE

Section 1024.37 of Regulation X limits the ability of servicers to charge members for force-placed insurance policies. The rule applies to federally related mortgage loans, not including open-end lines of credit (i.e., HELOCs).

Force-placed insurance is defined as hazard insurance obtained by a servicer on behalf of the owner or assignee of a mortgage loan that insures the property secured by the loan. This rule does not apply to flood insurance or renewing a member's hazard insurance under a member's escrow account.

Charging Force-Placed Insurance to the Member

Servicers must meet several requirements in order to impose force-placed insurance charges. First, there must be a reasonable basis to believe the member failed to maintain the required hazard insurance. Second, the servicer must provide the member with two notices. If, after providing those notices, the servicer still has not received adequate proof of insurance, it can force-place insurance on the property and charge the member for the cost. If the servicer later receives proof of the required hazard insurance, it must cancel the force-placed insurance within 15 days. The servicer must also refund any charges or fees related to overlapping coverage within those 15 days after receiving notice.

NAFCU NOTE

This NAFCU *Compliance Monitor* article covers the 2016 changes to the force-placed insurance requirements (member only).

Force-Placed Insurance Notices

The rule requires a first notice and a reminder notice. The first notice must be sent at least 45 days before charging the member for force-placed insurance. The reminder notice must be sent at least 30 days after the first notice.

Section 1024.37(c)(2) requires particular content for both the first and the reminder notices. Among other requirements, both notices must include a description of the requested proof of insurance and how the member may provide it, and a statement that the insurance the servicer has or will purchase may cost significantly more and may provide less coverage than coverage purchased by the member.

The reminder notice must contain a statement that the notice is the second and final notice, the cost of the force-placed insurance, and a statement that the information the member sent as proof of coverage is incomplete and the member must send the missing information to avoid being charged (if applicable).

Certain information must be in **bold text** on the notices, such as the request for proof of hazard insurance, and the statements that force-placed insurance may cost more and cover less. Appendix MS-3 has model forms that the servicer should review as proper use of the model forms will comply with the content and format rules. The notices may include the mortgage loan account number. However, no other additional information can be included.

Obtaining and Renewing Force-Placed Insurance

Servicers may request proof of hazard insurance from the member, including the policy declaration page, the insurance certificate, the policy or similar proof of coverage. Proof may be rejected if unconfirmed by the insurance agent or provider, or the policy does not conform with the requirements of the member's loan contract.

If the servicer meets the notice requirements and still does not receive adequate proof of hazard insurance, the servicer may impose force-placed insurance on the member. However, the charges must be bona fide and reasonable, meaning the cost imposed bears a reasonable relationship to the servicer's cost of providing the insurance and is not otherwise prohibited by applicable law. A servicer may also renew a force-placed insurance policy. However, the servicer must provide an annual renewal notice that explains the force-placed insurance and requests proof of insurance from the member. Appendix MS-3 also contains a model renewal notice form that, when properly used, meets the regulatory requirements.

Special Rules for Members with Escrow Accounts

Servicers may not obtain force-placed insurance for members who have escrow accounts established for hazard insurance, unless the servicer has reason to believe that the insurer cancelled the policy for reasons unrelated to non-payment or because the property is vacant. Even if a member has insufficient funds in the escrow account to pay the premium, the servicer must maintain the member's insurance. In this case, the servicer will have to advance the funds through the escrow account.

Servicers meeting the definition of “small servicer” may purchase force-placed insurance for members with an escrow account if two conditions are met. First, the member must be 30 days or more past due. Second, the force-placed insurance must cost less than the cost of the member’s hazard insurance premium.

SERVICING DELINQUENT MORTGAGES

Regulation X contains specific, detailed servicing requirements for loans which are delinquent. Sections 1024.39 through 1024.41 detail how servicers should initiate and maintain contact with members in delinquency to ensure they are aware of their options to resolve the delinquency and save their home.

These rules generally apply to all federally related mortgage loans on a member’s principal residence, except open-end lines of credit (i.e., HELOCs), reverse mortgage transactions and loans for which the servicer is a qualified lender under the Farm Credit Act of 1971. The small servicer exemption discussed later in this section applies to these requirements as well.

As defined in section 1024.31, “[d]elinquency means a period of time during which a borrower and a borrower’s mortgage loan obligation are delinquent. A borrower and a borrower’s mortgage loan obligation are delinquent beginning on the date a periodic payment sufficient to cover principal, interest, and, if applicable, escrow becomes due and unpaid, until such time as no periodic payment is due and unpaid.”

Early Intervention

Under Regulation X’s early intervention rule in section 1024.39, servicers are required to make good faith efforts to promptly provide loss mitigation information. Servicers must establish or make good faith efforts to establish live contact with members by the 36th day of delinquency for each payment. Additionally, a servicer must provide a member a written notice with information about loss mitigation options by the 45th day of a member’s delinquency.

RESEARCH TIP: While it is within each servicer’s reasonable discretion to determine the availability of loss mitigation options, the CFPB’s Small Entity Compliance Guide on the Mortgage Servicing Rules does contains helpful examples regarding that determination.

Establishing Live Contact

Under section 1024.39(a), a servicer must establish or make a good faith effort to establish live contact with a delinquent member within 36 days of the member's delinquency on a payment. To calculate the 36 days, start with the day a periodic payment for a given billing cycle is due and unpaid (even if the servicer gives the member a grace period after the payment is due before it assesses a late fee).

For example, if a payment due date is January 1 and the amount due is not fully paid during the 36-day period after January 1, the servicer must establish or make good faith efforts to establish live contact not later than 36 days after January 1 – meaning by February 6. If the member makes a full payment before the end of the 36-day period, the servicer need not establish live contact with them. This means if the member misses a January 1 due date but makes that payment on February 1, the servicer does not have to contact them by February 6.

Live contact with a member includes telephoning or conducting an in-person meeting with the member, but not leaving a recorded phone message. Servicers may rely on live contact established at the member's initiative to satisfy the live contact requirement of this rule.

Good faith efforts to establish live contact can mean reasonable steps under the circumstances to reach the member. That could include telephoning the member on more than one occasion or sending them a written or electronic communication encouraging them to establish live contact with the servicer.

Written Notice

By the 45th day of delinquency, the servicer must provide delinquent members with a written notice about loss mitigation options. It must do so even if it has provided the information previously during an oral live contact with the member. However, a servicer is not required to provide the written notice more than once during any 180-day period.

The notice must be clear and conspicuous, and include the specific content listed in section 1024.39(b)(2), including a statement providing a brief description of examples of loss mitigation options that may be available and the website to access either CFPB's list or the U.S. Department of Housing and Urban Development's (HUD) list of homeownership counselors and organizations with toll-free telephone numbers.

Model forms MS-4(A), MS-4(B) and MS-4(C) provide model language servicers may use for the written notice.

Bankruptcy and Fair Debt Collection Practices Act Exemptions

Where a member is a debtor in bankruptcy or the servicer is a debt collector under the Fair Debt Collection Practices Act (FDCPA) and the member has sent a written cease communication request, the servicer may be exempt from one or both of the early intervention requirements. Servicers are exempt from the live contact requirements while any member is in bankruptcy or when any member has submitted a written cease communication request. Servicers are only exempt from the written contact requirements when specific conditions are present indicating that the member cannot or will not try to bring the loan current.

If these conditions are not satisfied, then the credit union has an obligation to send a modified written notice. There are separate timing requirements for members in bankruptcy who are entitled to receive modified written notices under the rule. For members who have only requested to cease contact with the servicer under the FDCPA, the servicer is required to send a modified form of the written notice which includes model language regarding foreclosure found in model form MS-4(D). These modified written notices may not be sent more than once during any 180-day period.

Continuity of Contact with Delinquent Members

Section 1024.40 requires servicers to maintain reasonable policies and procedures with respect to providing delinquent members with access to personnel to assist them with loss mitigation options, where applicable.

Servicers must design policies and procedures that ensure a member is assigned personnel by the earlier of when a servicer provides a member the written notice required by the early intervention requirement or the 45th day of a member's delinquency. While it is up to the servicer whether to assign a single person or a team of personnel, the policies and procedures must guarantee that assigned personnel are able to assist the member by phone with loss mitigation options, including advising on the status of any loss mitigation application and applicable timelines. Additionally, assigned personnel should be able to access all information provided by the member and provide that information, when appropriate, to those responsible for evaluating the member for loss mitigation options.

Personnel must remain available until the members have made, without incurring a late charge, two consecutive mortgage payments in accordance with the terms of a permanent loss mitigation agreement or the mortgage, if the member becomes current. If a member re-defaults after making two payments, the clock resets and personnel must be available by the time the servicer sends the written notice required by the early intervention requirements, but in any event, by the 45th day of the delinquency.

NAFCU NOTE

The NAFCU *Compliance Monitor* articles on the 2016 changes to the rules about early intervention and loss mitigation can be a helpful resource for compliance officers applying these requirements in the context of a bankruptcy or successor-in-interest (member only).

Loss Mitigation

Servicers are required by section 1024.41 of Regulation X to follow specific loss mitigation procedures for a mortgage secured by a member's principal residence. It is important to understand that Regulation X does not require a servicer to offer any particular kind of loss mitigation option to a member. It only requires the member's application for loss mitigation to be evaluated in accordance with the process established in the rule.

Servicers that are debt collectors under the FDCPA to whom a member has sent a written cease communication request must still comply with these loss mitigation rules, unless the member specifically withdraws the request for loss mitigation.

Evaluating Applications

A loss mitigation application is an oral or written request for a loss mitigation option that is accompanied by any information required by a servicer for evaluation for a loss mitigation option. A loss mitigation application is complete if a servicer has received all the information that the servicer requires from a member in evaluating applications for the loss mitigation options available to the member. A servicer is required to exercise reasonable diligence in working with a member to obtain documents and information necessary to complete the application.

The timeline for processing applications depends on whether a foreclosure sale has been scheduled regarding the property. If the loss mitigation application is received 37 days or less before a scheduled foreclosure sale, the loss mitigation evaluation procedures established by section 1024.41 would not apply. However, the credit union would still need to comply with its own general procedures for evaluating loss mitigation applications.

If a servicer receives a complete loss mitigation application more than 37 days but less than 45 days before a foreclosure sale, it must evaluate it within 30 days for all available loss mitigation options and provide the member a written notice of its evaluation. The written evaluation must include:

- The servicer's determination of the particular loss mitigation options available to the member;
- The time period for accepting or rejecting the offer loss mitigation options;
- Specifics about why the application was denied for any loan modification option; and
- Information about any applicable appeal process.

For any application received 45 days or more before a foreclosure sale, the servicer must further make a determination as to whether the application was complete and provide a written notice within five days (excluding legal public holidays, Saturdays and Sundays) of that determination, and if incomplete, the information required to complete the application and the date when such information should be provided.

If an application is missing information not in the member's control, the servicer may not deny the application for missing information until it has taken further steps. The servicer must provide the member with a written notice describing the missing documents and exercise reasonable due diligence in obtaining the documents from the third party. If the documents are still missing after a significant period of time, then the application can be denied.

The staff commentary states that a "significant period of time" may include consideration of the timing of the foreclosure process. For example, if a member is less than 50 days away from a foreclosure sale, an application remaining incomplete for 15 days may be a more significant period of time under the circumstances than if the member is still less than 120 days delinquent on a mortgage loan obligation.

RESEARCH TIP: The CFPB's Small Entity Compliance Guide on the Mortgage Servicing Rules offers detailed guidance on meeting the rule's specific requirements and timelines for acknowledging loss mitigation applications, exercising reasonable diligence to make incomplete applications complete and correcting applications.

Period for Accepting or Rejecting Offers

Under section 1024.41, the amount of time a servicer must give a member to respond to loss mitigation offers also depends on the proximity of a foreclosure sale. When a member submits a complete loss mitigation application 90 days or more before a scheduled foreclosure sale (or at a time when no foreclosure sale is scheduled), a servicer must give the member at least 14 days to accept or reject a loss mitigation offer. When a member submits a complete loss mitigation application less than 90 days, but more than 37 days before a scheduled foreclosure sale, a servicer must give the member 7 days or more to accept or reject a loss mitigation offer.

If the member does not respond within the 7-day or 14-day deadline, a servicer can generally deem its loss mitigation offer as rejected. However, if the member does not satisfy a servicer's requirements for accepting a trial loan modification plan but timely makes trial plan payments, the servicer must give the member a reasonable period to fulfill any remaining requirements. Also, if a member exercises an available appeal right, the servicer must extend the deadline for accepting any loss mitigation option offered until 14 days after it provides the notice concerning how the appeal was resolved.

Appeals

Under section 1024.41(h), a member that submits a complete loss mitigation application more than 90 days before a foreclosure sale and is denied may appeal. These appeals must be reviewed within 30 days. This review must include an independent evaluation, meaning the personnel who evaluated the application cannot review the appeal. Supervisors may, however, review appeals so long as they were not directly involved in the initial evaluation of the member's completed application.

A servicer must notify the member of its decision within 30 days of receiving the appeal. Additionally, the servicer must afford the member 14 days to accept or reject an offer of a loss mitigation option resulting from the independent evaluation.

Dual Tracking

The rule prohibits dual tracking, which occurs when a servicer moves forward with foreclosure while simultaneously working with the member to avoid foreclosure. To prevent such practices, section 1024.41(f) prohibits a servicer from making the first notice or filing required for a foreclosure process until a member is more than 120 days delinquent.

If a member has submitted a complete loss mitigation application during the 120-day period, the servicer may not begin the foreclosure process unless:

- The servicer sends the member a notice that the member is not eligible for any loss mitigation options and the member has exhausted the appeal process;
- The member rejects all loss mitigation options the servicer offers; or
- The member fails to perform under an agreement on a loss mitigation option.

The same criteria above prevent a servicer from moving for foreclosure judgment or order of sale, or conducting a foreclosure sale where a member submits a complete loss mitigation application after a servicer has made the first notice or filing for the foreclosure process but more than 37 days before a scheduled foreclosure sale (or at a time when no sale has been scheduled).

In the case of facially complete application, a servicer must seek to complete the application and give the member a reasonable amount of time to provide the materials necessary to complete the application. In addition, a servicer may not make the first notice or filing for a foreclosure process or otherwise refer the member to foreclosure until the member has had a reasonable amount of time to provide the documents or information.

Servicing Transfers

Section 1024.41(k) contains specific loss mitigation requirements for service-transferred loans. If a loan is service transferred while a loss mitigation application is pending as of the transfer date, the new transferee servicer must comply with section 1024.41 within the same timeframes that applied to the previous (transferor) servicer, with a few exceptions. For example, if the effective date of the service transfer falls after a complete application has been received, but during the 5 day period for sending the notice of receipt of a complete application, the transferee servicer has 10 days (excluding legal public holidays, Saturdays and Sundays) from the transfer date – the date the transferee starts accepting payments – to send the notice. A servicing transfer does not affect the member's ability to accept or reject a loss mitigation option offered by a transferor servicer. For more information, see the CFPB's updated Small Entity Compliance Guide.

PAYOFF STATEMENTS

The rules for payoff statements apply to both open-end and closed-end loans on all dwellings, including HELOCs. The credit union is responsible for responding to requests for payoff statements, unless the credit union has sold the mortgage or the servicing rights to the mortgage. There is no small servicer exemption for the payoff statement rules.

Written Requests for Payoff Statements

If a member or someone acting on the member's behalf, such as an attorney, makes a written request for a payoff statement, the servicer must provide the statement within a reasonable time not to exceed seven business days. The payoff statement must be an accurate statement of the member's total outstanding balance that would be required to pay the loan in full as of a specified date. There are several circumstances under which the credit union would be considered unable to comply with this timeframe:

- The loan is in bankruptcy or foreclosure;
- The loan is a reverse mortgage;
- The loan is a shared appreciation mortgage; or
- Due to a natural disaster or similar circumstance.

In these situations, the payoff statement must be provided to the member within a reasonable time.

SERVICING TRANSFERS

Section 1024.33 of Regulation X establishes two disclosure requirements for servicers regarding the transfer of servicing rights for federally related mortgage loans. Both of these notices are required prior to any servicing transfer. Regulation Z's section 1026.39 also requires mortgage owners who acquire mortgage loans to provide borrowers with a post-transfer notice when their "mortgage loan" is sold, assigned or otherwise transferred. Regulation Z also requires disclosures and provides protections for payments made initially after the transfer.

NAFCU NOTE

This *Compliance Blog* post outlines what constitutes a servicing transfer and the various timing requirements for mortgage servicing transfer notices from the transferor and transferee servicers.

Reverse Mortgage Servicing Disclosure Statement

Section 1024.33(a) of Regulation X requires a loan originator that receives an application for a reverse mortgage transaction – as defined in section 1026.33(a) of Regulation Z – to provide a servicing disclosure statement to the member within three business days after receipt of the application. The disclosure must advise whether the servicing of the mortgage may be assigned, sold or transferred to another servicer. Appendix MS-1 of Regulation X contains sample language.

Pre-Servicing Transfer Notice

For a federally related mortgage loan covered by RESPA, except an open-end home equity plan (i.e., HELOC), which is being assigned, sold or transferred, the transferor (present servicer) must provide a disclosure at least 15 days before the effective date of the transfer. The servicing transfer notice applies to federally related mortgage loans (both first lien and subordinate liens).

A transfer of servicing notice from the transferee (new servicer) must be provided not more than 15 days after the effective date of the transfer. Both notices may be combined into one notice if delivered to the member at least 15 days before the effective date of the transfer. There are specific content requirements which are illustrated in Regulation X's Appendix MS-2.

Under section 1024.33(b)(2), the following transfers are not considered an assignment, sale or transfer of mortgage loan servicing for purposes of this requirement if there is no change in the payee, address to which payment must be delivered, account number or amount of payment due:

- Transfers between affiliates;
- Transfers resulting from mergers or acquisitions of servicers or subservicers; and
- Transfers between master servicers, when the subservicer remains the same.

Mortgage Transfer Disclosure

Section 1026.39 of Regulation Z requires any person who becomes the owner of an existing mortgage loan to provide a notice regarding the transfer. This requirement applies to:

- An open-end consumer credit transaction secured by the member's principal dwelling; or
- A closed-end consumer credit transaction secured by a dwelling or real property.

If partial payments will be accepted, the notice must include information about the new lender's policy regarding partial payments so borrowers will know how their payments will be processed during the transfer. The disclosure must include:

- If periodic payments less than the full amount due are accepted, a statement that the "lender" may accept such payments and apply them to the member's loan;
- If periodic payments less than the full amount due are accepted but the credit union does not apply the funds until the full amount is received, such as in a suspense account, a statement that the "lender" does this;

- If periodic payments that are less than the full amount due are not accepted, a statement that the "lender" does not accept any partial payments; and
- A statement that if the loan is sold, the new "lender" may have a different policy.

RESEARCH TIP: **In terms of formatting, the CFPB unfortunately did not provide a precise model form for the mortgage transfer disclosure. Rather, the bureau's staff commentary indicates that credit unions should utilize the partial payment language in Model Form H-25 to craft this disclosure.**

Payments Made During Service Transfers

During the 60-day period beginning on the date of transfer, section 1024.33(c) of Regulation X prohibits charging a late fee against a member who has made a timely payment to the wrong servicer.

If a payment is received incorrectly by the transferor servicer (rather than the transferee servicer that should properly receive the payment on the loan) once the effective date of transfer of servicing on a mortgage loan occurs, the transferor servicer must promptly either:

- Transfer the payment to the transferee servicer for application to a member's mortgage loan account, or
- Return the payment to the person that made the payment and notify such person of the proper recipient of the payment.

SMALL SERVICER EXEMPTION

As referenced throughout this section, small servicers are exempt from certain parts of the mortgage servicing rules. Specifically, small servicers are exempt from the following mortgage servicing requirements:

- General servicing policies, procedures and requirements;
- Periodic statements;
- Prohibition on purchasing force-placed insurance where a servicer could continue the member's existing hazard insurance coverage by advancing funds to escrow, under certain circumstances when the cost of force-placed insurance is less than the cost of advancing for hazard insurance; and

- The majority of the rules for servicing delinquent mortgages.

Small servicers must still comply with the below servicing requirements:

- Adjustable rate mortgage notices;
- Prompt crediting of payments;
- Responding to qualified written requests (the error resolution and information requests requirements);
- Escrow account servicing requirements;
- The remainder of the force-placed insurance requirements;
- Two provisions of the loss mitigation requirements:
    1) Small servicers must not make the first notice or filing for foreclosure unless a member's mortgage is more than 120 days delinquent; and
    2) Small servicers must not proceed to foreclosure judgment if the member is performing under the terms of a loss mitigation agreement;
- Payoff statements requirements; and
- Service transfer requirements.

NAFCU NOTE

Check out NAFCU's scope & applicability chart on the mortgage servicing regulations for a quick reference on when the small servicer exemption applies (member only).

Definition of a Small Servicer

A credit union is a small servicer if the credit union, together with any affiliates, services 5,000 or fewer mortgage loans and the credit union (or an affiliate) is the creditor or assignee for all of them.

If the credit union services any mortgage loans that the credit union (or an affiliate) did not originate or do not own, the credit union would not qualify as a small servicer, even if the credit union services 5,000 or fewer loans overall. For example, if the credit union owns the servicing rights for loans for which the credit union is neither the owner nor the entity to whom the obligation was initially payable, the credit union would not qualify as a small servicer.

Calculating the Threshold

The small servicer determination occurs each January 1 for the following calendar year and is based on the number of mortgage loans serviced by the servicer and any affiliates. When determining if a credit union qualifies as a small servicer, only consider the "mortgage loans" serviced by the credit union. Regulation Z defines "mortgage loan" to mean a closed-end consumer credit transaction secured by a dwelling. This does not include reverse mortgages or timeshare plans. Transactions serviced for a seller financer that meets the criteria of section 1026.36(a)(5) also should not be included.

A servicer can lose the small servicer exemption if it begins to service more than 5,000 loans or takes on the servicing of a loan it does not own or did not originate. If a servicer loses the exemption, it will have six months from the date it stopped being a small servicer or until the next January 1 (whichever is later) to comply with the mortgage servicing requirements from which it was exempt as a small servicer.

RESEARCH TIP: **The CFPB's Small Entity Compliance Guide on the Mortgage Servicing Rules offers detailed examples when a servicer either is considered or is no longer considered a small servicer.**

CHAPTER 3 — LENDING

SECTION 10 — LENDING TO SERVICEMEMBERS: THE MILITARY LENDING ACT AND SERVICEMEMBERS CIVIL RELIEF ACT

MILITARY LENDING ACT

The Military Lending Act (MLA), which was part of the John Warner National Defense Authorization Act of 2007, required the Department of Defense (DoD) to write rules protecting servicemembers from certain credit products that were seen as predatory to servicemembers and their families. Originally, these rules only applied to payday loans, vehicle title loans and tax refund anticipation loans. In 2015, the DoD broadly expanded the scope of the previous MLA regulations.

Most consumer credit products involving "covered borrowers" are subject to the regulation and its 36 percent interest rate ceiling, calculated using an "all in" Military Annual Percentage Rate (MAPR). The rule also contains disclosure requirements, prohibitions like limiting mandatory arbitration clauses and penalties for noncompliance such as voiding loan agreements.

RESEARCH TIP: **The MLA rules do not have any staff commentary, so for more detailed research, the 2015 preamble may be helpful. The DoD has released final interpretative rules in August 2016, December 2017 and February 2020 in an attempt to clarify some ambiguities with the rules.**

Scope of the Rule and Definitions of Key Terms

First, it is important to understand which loans are subject to the rule. There are several particularly significant definitions that help determine the when the rule applies. The definitions section borrows from Regulation Z in some respects – for example, the rule defines "creditor" in part by cross-referencing Regulation Z's definition. The definitions of "consumer credit" and "covered borrower" determine what loan products made to which members will be subject to the MLA's limitations.

Consumer Credit

The rule defines "consumer credit" in a manner that largely tracks the definitions of consumer credit, closed-end credit and open-end credit in Regulation Z. Consumer credit is credit which is "offered or extended to a covered borrower primarily for personal, family or household purposes," and is "subject to a finance charge or payable by a written agreement in more than four installments." There are several exceptions to the definition:

- Residential mortgages, meaning "any credit transaction secured by an interest in a dwelling," including loans to finance the purchase or initial construction of a dwelling, a refinance, a HELOC or reverse mortgage;

- Transactions that are "expressly intended" to finance the purchase of a motor vehicle or personal property, where the credit is secured by the vehicle or property being purchased;
- Loans that are exempt for the purposes of Regulation Z, such as business purpose loans; and
- Any loan where the credit union determines the member is not a "covered borrower."

Note that while a loan to purchase a motor vehicle is excluded, there is not a specific carve out in the definition for refinancings of auto loans. There is also no exception for loans secured by vacant land.

NAFCU NOTE

This NAFCU *Compliance Blog* post explains how the December 2017 final interpretive rule had clarified that loans to purchase a motor vehicle or personal property that also involve the purchase of other products or a cash advance may be considered a "hybrid" loan that could fall out of the exception. Under the December 2017 interpretive rule, an auto loan that includes financing for guaranteed asset protection, or "GAP" insurance, would not qualify for the exception and would have to comply with the MLA. The DoD's February 2020 interpretive rule withdrew this particular interpretation and reverted back to the interpretation from the August 2016 interpretive rule. This NAFCU *Compliance Blog* post explains the effect of the February 2020 interpretive rule and whether loans that include financing of GAP insurance along with the acquisition of a motor vehicle qualify for the motor vehicle purchase exception from the definition of consumer credit.

Covered Borrower

The rule also only applies to loans made to a "covered borrower," which is defined based on the member's connection to the military when they "become obligated" or establish an account for consumer credit. Specifically, active duty members of the armed forces (e.g., Army, Navy, Air Force, Coast Guard, etc.) or certain active Guard and Reserve duty and certain dependents of these individuals as defined under federal law are covered borrowers.

EXAMPLE

The MLA regulation provides the following example for when a loan is made to a covered borrower: "Consumer A is a member of the armed forces but not serving on active duty, and holds an account for closed-end credit with a [credit union]. After establishing the closed-end credit account, Consumer A is ordered to serve on active duty, thereby becoming a covered borrower, and soon thereafter separately establishes an open-end line of credit for personal purposes…with the [credit union]. [The MLA] applies to the open-end line of credit, but not to the closed-end credit account."

Dependents who are covered borrowers include:

- A servicemember's spouse;
- A child or unmarried person in the servicemember's legal custody who is under 21;
- A child or unmarried person in the servicemember's legal custody under age 23, enrolled in certain educational programs and dependent on the servicemember for over one-half of the person's support;
- A child or unmarried person who is in the service member's legal custody for a period of at least 12 months and is incapable of self-support due to a mental or physical incapacity that occurred while the person was the servicemember's dependent. The person must also be dependent on the servicemember for over one-half of the person's support; or
- A parent or parent-in-law who lives with the servicemember and is dependent on the servicemember for over one-half of the person's support.

Calculating the Military Annual Percentage Rate (MAPR)

MLA covered loans are subject to a 36 percent MAPR cap. The MAPR is calculated to include not only those items which are finance charges under Regulation Z, but also specific fees that may otherwise be excluded by Regulation Z. Specifically, the MAPR includes:

- Any credit insurance premium or fee, including charges for single premium credit insurance;
- Any fee for a debt cancellation contract or any fee for a debt suspension agreement; and
- Any fee for a "credit-related ancillary product" sold in connection with the loan.

Other than certain "bona fide" fees, discussed in further detail below, the MAPR also includes:

- Finance charges;
- Application fees, other than one fee charged in a rolling 12-month period for a "short-term small amount loan" offered by a federal credit union or insured depository institution; and
- Certain participation fees.

MORE INFORMATION: Federal credit unions with Payday Alternative Loan (PAL) programs and credit unions offering other short term loan programs may want to review the particular definition of "short-term, small amount loan" in the MLA as this impacts whether some application fees can be excluded from the MAPR calculation.

Bona Fide Fees

Under the rule, some fees for credit card accounts may be excluded from the MAPR by meeting the rule's standards as bona fide fees that are "reasonable for that type of fee." Fees that do not meet these standards must be included in the MAPR. Credit insurance, debt cancellation, debt suspension or other credit-related ancillary products are ineligible and may not be excluded even if bona fide and reasonable.

The rule utilizes a “like-kind” standard to determine whether a bona fide fee is reasonable, comparing the credit union’s fee to the fees “typically imposed by other creditors for the same or a substantially similar product or service.” There is a safe harbor if the fee is less than or equal to the average amount of a fee for “the same or a substantially similar service” charged by five or more creditors who each have at least $3 billion in outstanding credit card balances during a three-year look back period.

EXAMPLE

The rule provides the following example of bona fide fees: “…when assessing a bona fide cash advance fee, that fee must be compared to fees charged by other creditors for transactions in which consumers receive extensions of credit in the form of cash or its equivalent. Conversely, when assessing a foreign transaction fee, that fee may not be compared to a cash advance fee because the foreign transaction fee involves the service of exchanging the consumer's currency (e.g., a reserve currency) for the local currency…and does not involve the provision of cash to the consumer.”

Even outside of this safe harbor, it is still possible for a fee to be reasonable when higher than this average amount. The reasonableness of the fee would “[depend] on other factors” relating to the card account, although the rule does not provide clarification as to what factors these may be. There are also separate standards for determining whether a participation fee is reasonable.

NAFCU NOTE

For more details on this safe harbor, see this NAFCU *Compliance Blog* post.

MAPR Computation

The rule specifies how to calculate the MAPR for both open- and closed-end credit by essentially cross-applying the calculation methods utilized by Regulation Z. For closed-end credit, the MAPR "shall be calculated following the rules for calculating and disclosing the [APR]" based on the applicable charges included in the MAPR.

MORE INFORMATION: The preamble clarifies that the MAPR calculation involves applying the standards in section 1026.22(a)(1) and the explanations and instructions found in Appendix J to Regulation Z.

For open-end credit, the MAPR is calculated by following the rules in sections 1026.14(c) and (d) of Regulation Z, using all charges that must be included in the MAPR. However, if the MAPR cannot be calculated in a particular billing cycle because there is no balance, then the credit union may not impose any fee or charge for that cycle with a narrow exception for certain participation fees.

Particularly for open-end credit, the MAPR could exceed 36% during a particular billing cycle, such as if the loan has a low balance. In this kind of situation, credit unions are expected to waive fees or finance charges in order to avoid exceeding the MAPR cap in any given billing cycle.

Disclosures to Covered Borrowers

The rule requires creditors to provide the following disclosures to covered borrower:

- A statement of the MAPR applicable to the consumer credit, which can be satisfied through a model disclosure or by describing the charges that may be imposed and included in the MAPR; it is not required to provide the calculated numerical MAPR or to describe the total dollar amount of charges in the MAPR;
- Any disclosure required by Regulation Z, provided in accordance with the provisions of Regulation Z that apply to the particular disclosure; and
- A "clear description" of the member's payment obligation, which may be made using a payment schedule for closed-end credit or account opening disclosures for open-end credit.

The rule contains a MAPR model disclosure statement. MLA disclosures must be provided to covered borrowers for new consumer credit accounts as well as any refinancing that would require new disclosures under Regulation Z.

Delivery of Mandatory Disclosures

There are both written and oral disclosure requirements in the rule. The written disclosures must be provided in a form the member can keep, but the oral disclosures can be provided either in person or via a toll-free number. When using a toll-free number to provide oral disclosures, the credit union must include the number on either the application or along with the written MLA disclosures. The information must be available at that phone number at the time the credit union provides the disclosures.

The oral disclosures should provide a "clear description of the payment obligation" which is a payment schedule for closed-end credit and an account opening disclosure for open-end credit. For closed-end credit, this seems to be the payment schedule from section 1026.18(g) of Regulation Z. For open-end credit, the rule and preamble just broadly reference the Regulation Z account opening disclosures.

The DoD's 2016 interpretative rule clarifies that reading all of the member's account opening disclosure does satisfy the rule, but it is not the only way to comply. The DoD gave two non-exclusive examples of how a credit union can make disclosures more briefly:

- describe how minimum payments are calculated on open-end credit plans then refer the covered borrower to the written materials the borrower will receive in connection with opening the plan; or
- describe borrowers' obligations to make a monthly, bi-monthly, or weekly payment as applicable under the borrowers' agreements.

Now that the DoD has clarified that generic messages that do not address a covered member's specific loan terms are permissible, this could open the door to prerecorded disclosures.

NAFCU NOTE

For more information on the MLA, review NAFCU's *MLA Compliance Guide* (member only). There are also numerous NAFCU *Compliance Blog* posts on this topic.

Identifying Covered Borrowers

While the MLA permits a credit union to use its own method to determine whether a member is a covered borrower, the rule provides a safe harbor when a credit union uses one of two methods:

1. The MLA Database, maintained by DoD, or
2. Information regarding a member's status that is obtained from a consumer report obtained from a nationwide consumer reporting agency (e.g., Experian).

These two methods for identifying covered borrowers give a legally conclusive mechanism as to whether the member qualifies for MLA protections. In other words, if the covered borrower check indicates the member is not an MLA covered borrower, there is protection if that member later asserts the MLA applied and the credit union did not comply. If the credit union opts to use one of these two methods to determine if a member is a covered borrower, it must create and maintain a timely record of the determination to receive the benefit of the safe harbor.

Additionally, the rule only requires the credit union make the determination once if the information is obtained at the time that:

- The member initiated the transaction or within 30 days prior to that time;
- The member applies to establish the account or within 30 days prior to that time; or
- The credit union develops or processes a firm offer of credit, and the member responds to that offer no more than 60 days after the offer is provided to the member.

There is no need to perform an additional check right before finalizing the loan unless the credit union receives a response to a firm offer of credit more than 60 days after the offer is presented to the member.

Other Limitations and Penalties for Noncompliance

The rule contains specific limitations for MLA covered loans. For example, the rule prohibits creditors from requiring covered members to waive rights under the Servicemembers Civil Relief Act (SCRA), mandating arbitration or imposing “other onerous legal notice provisions in the case of a dispute.” The rule also limits the credit union’s ability to use a check or other method to access the covered member’s deposit or savings account in connection with the credit transaction. Penalties for violating the regulation include voiding of the credit agreement, civil liability including statutory and punitive damages and misdemeanor criminal charges.

NAFCU NOTE

For a deeper dive into the limitations on MLA covered loans, see the discussion starting on page 34 of NAFCU’s *MLA Compliance Guide* (member-only).

THE SERVICEMEMBERS CIVIL RELIEF ACT

The Servicemembers Civil Relief Act of 2003 (SCRA) updated the protections provided to the nation’s armed forces as they enter active duty. Key purposes of the SCRA include easing financial burdens on those who enter active duty military service and protecting their legal interests. SCRA protection begins when the member enters “military service” – i.e., active duty status. Active duty status means full-time duty in military service, including full-time training duty (boot camp) and annual training duty. Individuals covered by the SCRA include members of the Army, Navy, Air Force, Marine Corps and Coast Guard. National Guard members are only covered if they are called to duty by the President or Secretary of Defense for a period of over thirty consecutive days in response to certain national emergencies. In some limited cases, the SCRA can also protect a servicemember’s dependents (e.g. evictions) or those who co-signed a loan for a servicemember.

RESEARCH TIP: For more information on SCRA issues, credit unions may find the Department of Justice’s resources helpful as well as this summary from the Congressional Research Service.

The SCRA provides interest rate reductions, protections against foreclosure and repossession, the ability to terminate leases, limitations on evictions, and specific safeguards during civil legal proceedings. There are no underlying regulations or guidance regarding the SCRA, and a credit union will need to look directly to the law when considering SCRA issues.

RESEARCH TIP: **Do not forget to also research state laws in this area, as many states have adopted provisions that provide more protections than the SCRA, and some extend similar protections to a broader group of reservists or National Guard members.**

Six Percent Cap on Interest Rate

The most common SCRA provision that arises for credit unions is the six percent interest rate cap. Section 527 of the SCRA limits the amount of interest that can be charged on financial obligations that were incurred prior to military service to six percent, including most fees. This includes both the debts of the servicemember or a debt incurred jointly by a servicemember and their spouse. If a servicemember is eligible for and requests this protection, the credit union must reduce the interest rate.

"Interest" is defined broadly in the SCRA to include service charges, renewal charges, fees (including late fees), or any other charge other than bona fide insurance costs. Any interest above six percent must be retroactively waived to the date of the member's entry into military service. All interest above the cap must be forfeited by the credit union and cannot be added back after a member leaves military service. In other words, the credit union is required to forgive all interest greater than six percent; it is not a deferment of interest owed. The credit union must also be sure to reduce the required payments by the amount of interest forgiven and maintain the same maturity date.

NAFCU NOTE

For additional details on the SCRA see this NAFCU *Compliance Monitor* article (member-only) and this blog concerning late fees.

The six percent cap applies to most kinds of loans, including mortgages, car loans, credit cards and certain student loans. For most loans, the six percent cap only extends for the period of the member's military service. Mortgages receive special protection, where the interest cap also extends for one year after the end of military service.

For open-end credit like credit card accounts, the rule is a bit more complex. Generally, an existing credit card balance would receive the six percent cap once a member entered active duty. However, future purchases on the credit card would not be covered because the transactions would occur after military service begins.

Technically, the SCRA allows a credit union to ask a court to grant relief and determine that the servicemember's military service did not "materially affect" their ability to pay the obligation. For example, maybe the servicemember has more income as opposed to less after joining the military. However, it is not common for credit unions to seek this relief as it means incurring legal costs and can create reputation risk.

NAFCU NOTE
For additional information on the notification requirements, check out this NAFCU *Compliance Blog* post.

Notification Requirements

The SCRA states that for a loan to be subject to the six percent cap, a servicemember must provide notice to the credit union no later than 180 days after the termination or release from military service. Specifically, the servicemember must provide written notice and a copy of their military orders or any other appropriate indicator of military service such as a letter from a commanding officer. Alternatively, a credit union may use information from the DoD's Defense Manpower Data Center to determine whether a servicemember was on active duty.

SCRA Protections Impacting Automobile Lending and Leasing

In many states, lenders are permitted to repossess property that secures a loan which is in default without an order or judgment from a court. However, the SCRA protects servicemembers' legal interests in some specific ways. This includes a prohibition against repossessing an automobile without a court order. To receive this protection, the servicemember is not required to notify the credit union of possible SCRA rights. Rather, it is the credit union's responsibility to determine a member's possible SCRA status prior to undertaking a repossession. The same is true for foreclosures and evictions.

Improper repossessions from a servicemember carry large reputation risks as well as fines and penalties from the Department of Justice, whose investigations tend to be quite time consuming. Checking the Defense Manpower Data Center SCRA database prior to repossessing a vehicle can help limit risks. If a borrower is covered by the SCRA, local counsel can assist in obtaining a court order for the repossession.

NAFCU NOTE
For more on the potential consequences of repossessing a servicemember's property in violation of the SCRA, see this NAFCU *Compliance Blog* post.

Automobile Leases

The SCRA allows a member to terminate an existing auto lease if she enters military service for a period of 180 days or more. Additionally, for leases entered into after military service begins, a member can terminate the lease if he or she is deployed outside the continental United States. To terminate the lease, the servicemember must provide written notice and a copy of the orders and return the vehicle. The credit union is not permitted to charge the servicemember early termination fees but can charge for mileage overages and normal wear and tear.

MORE INFORMATION: This Federal Reserve *Consumer Compliance Outlook* article includes some frequently asked questions on the SCRA and contains useful information.

Foreclosure and Eviction Protection

The credit union cannot foreclose on a mortgage entered into by a servicemember prior to military service without a court order. This protection extends throughout the servicemember's military service and for an additional one year after the end of military service. Unlike the interest rate cap, the servicemember is not obligated to provide notice to the credit union that he or she is entitled to these protections. Keep in mind that federal law requires credit unions to send borrowers an SCRA Notice Disclosure notifying members of their potential rights under the SCRA. This notice must be sent before a member becomes 45 days delinquent and must be sent if, among other things, the loan is secured by the member's principal residence and the member is or expects to be unable to make loan payments.

Credit unions can also end up in possession of homes after a foreclosure, including properties that the previous owner rented out to others. In other words, the credit union may end up as the landlord. The SCRA prohibits landlords from evicting servicemembers or their dependents from a residence during military service without a court order. There is an exception if the monthly rent exceeds a certain threshold, adjusted annually for inflation. Additionally, servicemembers have the ability to terminate residential leases in certain situations.

Safe Deposit Boxes

Finally, the protections in the SCRA for lease agreements go beyond just vehicle or residential leases. While this may vary from state to state, a safe deposit agreement is often considered a lease. If so, repossession would generally be prohibited without a court order if a deposit or payment was made on the agreement before the servicemember entered military service

MORE INFORMATION: The Military Lending Act section of the Office of the Comptroller of the Currency's Handbook contains a useful side by side chart comparing the SCRA to the MLA.

CHAPTER 3 — LENDING

SECTION 11 — FAIR LENDING AND REGULATION B

OVERVIEW

This section does not cover fair lending guidelines in a comprehensive fashion. Rather, the goal is to generally describe the applicable laws and concepts, potential issues that could result in fair lending violations and the regulatory requirements. The section will extend beyond traditional fair lending topics and will discuss issues such as advertising and debt collection.

FAIR LENDING LAWS

When evaluating a credit union's fair lending compliance program, the first things to consider are the applicable laws and regulations. The following must be included in a credit union's fair lending compliance program:

- Equal Credit Opportunity Act (ECOA) - as implemented by Regulation B (12 CFR § 1002);
- Home Mortgage Disclosure Act (HMDA) - as implemented by Regulation C (12 CFR § 1003);
- The Fair Housing Act (FHA);
- NCUA's rules and regulations concerning nondiscrimination requirements for real estate-related loans; and
- Any state laws on fair lending or discrimination.

Several federal agencies have fair lending enforcement authority over credit unions, including NCUA, the CFPB, HUD and the U.S. Department of Justice (DOJ). NCUA is required to refer a case to DOJ if the results of a fair lending exam indicate legal action is appropriate.

MORE INFORMATION: **For more on HMDA and Regulation C, see Section 2 of the Appendix.**

FAIR LENDING EXAMINATIONS

NCUA examines federal credit unions with assets of less than $10 billion, state authorities examine state-chartered credit unions with assets under $10 billion and the CFPB examines credit unions with assets of $10 billion or more. This section will focus on NCUA's Fair Lending Examination Program.

NCUA conducts fair lending examinations on a risk-based schedule. NCUA's Letter to Federal Credit Unions 13-FCU-02 outlines NCUA's Fair Lending Examination Program. Importantly, the letter discusses: educational and compliance tools to help federal credit unions comply with fair lending laws; the introduction of off-site supervision contacts; and the criteria for a fair lending examination and off-site supervision contacts selection. The letter also includes NCUA's Fair Lending Guide.

NCUA's Fair Lending Guide is based on the FFIEC's fair lending examination procedures and the agency conducts its fair lending exams in accordance with the FFIEC guidelines. NCUA's guide provides a summary of the fair lending laws and regulations that affect federal credit unions, specifically the ECOA, FHA and HMDA. However, it does not cover all the federal consumer protection laws or any state laws. NCUA's Fair Lending Guide also:

- Discusses the operational requirements of these fair lending laws and regulations;
- Lists review considerations that management should consider when developing fair lending compliance policies or evaluating fair lending issues;
- Provides checklists that serve as a starting point for developing fair lending compliance policies or as a test for compliance with the regulations; and
- Contains the applicable definitions for the laws and regulations.

RESEARCH TIP: NCUA's Fair Lending Compliance Resources webpage **includes a number of useful resources, including frequently asked questions. These documents are important guidance for addressing fair lending compliance.**

NCUA's guide provides a broad overview of the fair lending requirements, and the checklists can be useful tools. However, as with all regulatory requirements, there is no substitute for reading and understanding the regulations, especially Regulation B, which implements the Equal Credit Opportunity Act.

REGULATION B

Regulation B is located at 12 CFR Part 1002 of the CFPB's regulations and plays a variety of roles in the credit process. One main purpose of Regulation B is to promote credit availability to all creditworthy applicants by preventing discrimination. Regulation B accomplishes this goal by prohibiting financial institutions from considering certain information when evaluating an application and making a credit decision. Regulation B also regulates the timeframe for evaluating applications and the notices credit unions must send when taking adverse action.

MORE INFORMATION: **Regulation B also requires credit unions to provide copies of appraisals and valuations for dwelling-secured loans. These requirements are covered in Section 7 of this chapter.**

Applications

Under section 1002.2(f), an application is defined as an oral or written request for an extension of credit that is made in accordance with procedures used by the credit union for the type of credit requested. The term “procedures used” means the actual practices the credit union uses to make the credit decision as well as the credit union’s stated application procedures. For example, the credit union might take oral requests for credit as well as having a written application form. In that situation, both requests would be considered applications as the credit union has procedures to accept both oral and written requests for credit.

A “completed application” exists when the credit union has received all the information it usually obtains and considers in evaluating applications for the amount and type of credit requested. The regulation requires the credit union to conduct reasonable due diligence to obtain the required information. For example, the creditor should request information from third parties, such as a credit report, promptly after receiving the application. If additional information is needed from the applicant, such as an address or a telephone number to verify employment, the creditor should contact the applicant promptly.

RESEARCH TIP: **Be sure to check out the comprehensive staff commentary located in Supplement I to Regulation B. This is where the regulators go into additional detail about when an application is complete and other helpful matters.**

Inquiries Versus Applications

Credit unions routinely respond to member inquiries about available loan terms. A credit union needs to be careful that its responses to member inquiries do not reach the level of an application. For example, if during the response the credit union evaluates the member’s information and decides to deny the request, and communicates this decision to the member, the credit union has treated the inquiry as an application. Importantly, whether the inquiry or prequalification request becomes an application depends on how the credit union responds to the member, not on what the member says or asks.

The staff commentary includes examples of when inquiries are not applications and when certain inquiries could become applications under section 1002.2(f). For example, if a member calls to ask about loan terms and an employee explains the credit union's basic loan terms, such as interest rates, loan-to-value ratio and debt-to-income ratio, this would be considered an inquiry. Similarly, the credit union may treat the request as an inquiry if the credit union evaluates specific information about the consumer and tells the member the loan amount, rate and other terms of credit the member could qualify for under various loan programs, explaining the process the member must follow to submit an application and the information the creditor will analyze in reaching a credit decision.

Alternatively, an inquiry could become an application in a preapproval situation where the credit union reviews a request by evaluating a member's creditworthiness and approves or denies the member's request and communicates that decision to the member. However, certain prequalification requests may still be considered inquiries rather than applications under Regulation B. The credit union should ensure its staff is properly trained on when communicating certain loan information to a member could be considered a response to an application for Regulation B and trigger additional requirements for the credit union.

NAFCU NOTE

Check out this NAFCU *Compliance Blog* post for further analysis on when an inquiry becomes an application under a credit union's prequalification or preapproval program.

Timeframe for Responding to Applications

Within 30 days of receiving a completed application, section 1002.9(a) requires the credit union to notify the member of its decision – whether it is an approval, counteroffer or denial. The 30-day clock starts ticking when the credit union has obtained all the information it normally considers when making a credit decision. In practice, most credit unions provide credit decisions much quicker than the 30-day requirement in order to stay competitive and provide timely information to members.

If the credit union provides the member with a counteroffer, section 1002.9(a) requires the credit union to notify the member of its decision within 90 days after the counteroffer date if the member has not expressly accepted the counteroffer. The credit union does not have to keep the counteroffer open for a set period of time and can adjust the acceptance period of the counteroffer. If a member does not accept a credit union's counteroffer, the credit union would need to send an adverse action notice if it did not include one with the counteroffer notice.

If a member expressly withdraws the application, the credit union is not required to complete the decision process and is not required to send a notification to the member.

Responding to Incomplete Applications

Credit unions have several options when responding to incomplete applications. Under section 1002.9(c), the credit union could respond within 30 days after taking adverse action on an incomplete application. Alternatively, the credit union could send the member a "Notice of Incompleteness" informing the member of the required information and the time period for the member to respond. If the member does not respond to the notice with the required information within the timeframe, the credit union is not required to take further action (i.e., no adverse action notice is needed). However, if the member does provide the required information the credit union would need to respond to the member within 30 days as it would then have a completed application to consider.

At its option, the credit union could inform the member of the required additional information orally (i.e., in person or over the phone). However, if the member does not provide the additional information, the credit union would need to send an adverse action notice. In short, if the credit union sends the written "Notice of Incompleteness" it does not have a further obligation; however, if the credit union informs the member orally, it must follow up with an adverse action notice if the member does not respond.

NAFCU NOTE

This NAFCU *Compliance Blog* post provides further information on incomplete applications and the notice requirements.

Adverse Action Notices

One of the most prominent requirements in Regulation B is to send adverse action notices. The term "adverse action" is a defined term in Regulation B which also provides various examples of what is and is not considered adverse action. Examples of adverse action include:

- A refusal to grant credit in substantially the amount or on substantially the terms requested in an application;
- If the credit union provides a counteroffer to a member's application and the member does not accept the counteroffer (including if the member never responds);
- A termination of a credit account;

- An unfavorable change in account terms that does not affect substantially all of the credit union's members;
- A refusal to refinance or extend a member's loan; or
- A refusal to increase the amount of credit available to an applicant who has made an application for an increase.

Examples of actions that are not adverse include:

- If the credit union provides a counteroffer to a member's application and the member accepts the counteroffer;
- A change in terms expressly agreed to by a member;
- Any action taken on an account related to a member's inactivity, default or delinquency;
- A refusal or failure to authorize a transaction at point of sale;
- A refusal to extend credit because applicable law prohibits the credit union from extending the credit requested; or
- A refusal to extend credit because the credit union does not offer the type of credit or credit plan requested.

Content of Adverse Action Notices

If adverse action is taken, section 1002.9(a)(2) requires the credit union to send the member an adverse action notice, in writing, which includes a statement of the action taken and the specific reasons for the action taken. The notice must also contain required language explaining how the ECOA prohibits creditors from discriminating against credit applicants.

The statement of reasons must be specific and indicate the principal reason(s) for the adverse action. Statements that the adverse action was based on the credit union's internal standards or policies or that the applicant, joint applicant or similar party failed to achieve a qualifying score on the credit union's credit scoring system are insufficient. Alternatively, the credit union could provide the notice without the specific reasons if it includes a statement about the member's right to request the specific reasons and the process for doing so.

Credit unions are also required to list the name and address of the federal agency responsible for enforcing the ECOA and Regulation B for that particular credit union. Appendix A to Regulation B contains the list of federal agencies required to be listed on adverse action notices. Credit unions over $10 billion in assets should include the CFPB's name and address. Federal credit unions with assets of $10 billion or less are required to include the address for NCUA's Office of Consumer Financial Protection (OCFP). A state-chartered credit union would use the FTC address in option 9 from Appendix A.

EXAMPLE

Appendix C to Regulation B contains model notifications the credit union can use to draft its notices to its members. A credit union can use all or a portion of the forms contained in the Appendix. The credit union should determine which model fits its practices the best and modify the form to ensure it is accurate and includes all the required disclosures.

Timeframe for Sending Adverse Action Notice

With respect to a completed application, section 1002.9(a) requires the credit union to send the notice within 30 days after receiving the credit application. Similarly, the credit union needs to send an adverse action notice within 30 days after adverse action on an existing account. Of course, for member service reasons and reputation risk issues the credit union may want to ensure it sends notice as soon as reasonably practicable to ensure members receive the information in a timely fashion. A special 90-day timing rule applies to adverse action notices triggered when a member does not accept the credit union's counteroffer. In those situations, the credit union could meet its requirement by sending a combined notice to the member that includes both the counteroffer and the adverse action notice. In that scenario, if the member ultimately declines the counteroffer the credit union has already provided the adverse action notice and does not need to send a second notice. This prevents having to track all counteroffers and adverse action notices at a later date.

Relationship with Other Regulations

In addition to the Regulation B adverse action notice requirements for credit accounts, credit unions are required to send members an adverse action notice under the Fair Credit Reporting Act (FCRA) when the credit union uses information obtained from a consumer reporting agency to take a negative action on the member's account or application. Appendix C to Regulation B contains examples of the FCRA adverse action notice language, including the credit score disclosure information, as well as combined forms that credit unions could send that include the language of both required notices.

Regulation V, which implements the FCRA, includes a requirement for credit unions to send risk-based pricing notices when granting credit to a member on terms that are less favorable than the terms granted to other members (i.e., a higher annual percentage rate). One of the exceptions to the risk-based pricing notice rules occurs when the credit union sends the member an adverse action notice. This makes sense as the adverse action notice is sent when the credit union denies credit, whereas the risk-based pricing notice is required when the credit union grants credit on less favorable terms.

MORE INFORMATION: Refer to Section 12 of this chapter for more information on the FCRA adverse action and risk-based pricing notices. The section also includes details on the requirement to include credit score information on adverse action notices when a credit score was used to make a credit decision.

Discrimination on a Prohibited Basis

Section 1002.4 forbids any discrimination against an applicant, on a prohibited basis, regarding any aspect of a credit transaction. This also extends to advertising or other actions that could discourage, on a prohibited basis, a consumer from submitting or pursuing an application.

Under Regulation B, credit unions cannot discriminate on any of the following bases:

- Race, color, religion, national origin, sex, marital status or age (provided that the applicant has the capacity to enter into a binding contract);
- The fact that all or part of the applicant's income derives from any public assistance program; or
- The fact that the applicant has, in good faith, exercised any right under the Consumer Credit Protection Act or any state law upon which an exemption has been granted by the Board.

Regulation B contains numerous prohibitions when considering and evaluating a member's application. A credit union should review the specific details of the regulation when evaluating its application procedures. The examples below are provided to demonstrate some of the areas where Regulation B issues could arise.

Intent to Apply Jointly

For joint applications for credit, credit unions need to have evidence of the members' intent to apply jointly for credit. The commentary to section 1002.7(d) explains the credit union is required to obtain documentation of the members' intent. This documentation could be a signature or initials on the application itself to indicate the intent to apply jointly (each borrower should make the indication). Signatures on a promissory note are not sufficient nor are signatures on a joint financial statement as neither clearly indicate the intention of all parties to apply jointly for credit.

EXAMPLE

The model application forms in Appendix B include examples of proper methods to record members' intent.

For phone applications, a credit union will want to ensure it has procedures requiring employees to obtain and document whether members intend to apply jointly for credit. This documentation, which could be a loan officer's notes or a separate form, might be requested by an examiner seeking evidence that joint credit was intended.

Part of the reason for this requirement is Regulation B prohibits a credit union from requiring a cosigner on an application if a member qualifies for credit independently. Obviously, in the situation of a joint application the member is not applying independently for credit – but the only way to prove the members intended to apply for joint credit rather than individual credit with another person supporting the application is to obtain and document their intent.

Treating Non-Married Joint Applicants the Same as Married Joint Applicants

Regulation B prohibits a credit union from using marital status as a factor in its credit evaluations. Section 1002.6(b)(8) indicates that credit unions must evaluate married and unmarried applicants using the same standards. When evaluating applications, credit unions must treat joint applicants the same regardless of whether the joint applicants are married to each other or are two unrelated joint applicants.

Some fair lending exams have resulted in findings indicating financial institutions are charging non-married joint applicants higher fees for credit reports than for married joint applicants. This situation might occur if credit bureaus provide one joint credit report for married joint applicants while non-married joint applicants receive two individual credit reports and pay higher fees in the process. Fair lending examiners have indicated that non-married joint applicants are disadvantaged (compared to married joint applicants) because they may be paying more for credit report fees. As minimal as those concerns seem, it is often small findings, like this example, which prompt examiners to conduct a more thorough fair lending examination, potentially costing the credit union significant time and resources. One possible solution to this would be to review the credit union's credit report fees and ensure all applicants are charged the same fee. If that is not the case, consider reducing the fee for applications that result in two credit reports to the level of the fee for one credit report to ensure all applicants are treated similarly.

RESEARCH TIP: For more information, see this Federal Reserve *Consumer Compliance Outlook* article on marital status discrimination and establishing joint intent.

Driver's License in Loan Files

Some credit unions have reported examiners citing the institution because the credit union had copies of a member's driver's license in the loan file. The concern is that the credit union could be using the member's race or sex to discriminate against the borrower. Thus, it may be prudent to review the credit union's practices and procedures to remove any suspicion of these types of fair lending issues in order to prevent any issues with examiners.

Collection of Information for Monitoring Purposes

Section 1002.13 has an information collection requirement for credit applications primarily for extensions of secured credit for the purchase or refinance of a member's primary dwelling. Applications for credit secured by the applicant's principal residence but made primarily for a purpose other than the purchase or refinancing of the principal residence (such as loans for home improvement and debt consolidation) are not subject to the information collection requirements. Thus, an application for a home equity loan is not subject to this section unless the primary purpose is the purchase or refinancing of a principal dwelling.

MORE INFORMATION: Regulation B's information collection requirement is distinct from the Regulation C/HMDA collection process which is detailed in Section 2 of the Appendix. Credit unions are required to ensure its processes are compliant with both regulations.

The credit union is required to disclose to the member that the information is being requested by the federal government for the purpose of monitoring fair lending laws. The credit union can request the information on the application itself or on a separate form. The credit union's application shall ask for the required information but not require the information. The application should include a place for the applicant to decline to provide the information; however, the credit union must also disclose that if the applicant chooses not to provide the information the credit union is required to provide the information on the basis of visual observation or surname. See the model application forms in Appendix B of Regulation B for sample language the credit union can use.

Credit unions are required to ask applicants to provide the following information:

- Ethnicity;
- Race;
- Sex;
- Marital status – using the categories married, unmarried, separated; and
- Age.

This request must also occur on applications that are conducted over the phone as well as applications that are mailed to the member. If the member fails to provide the information in a mail application, the credit union does not need to make a special request for the information.

Record Retention

Like many other regulations, Regulation B has special record retention requirements. Under section 1002.12, applications must be retained for at least 25 months after the credit union notifies the applicant of the action taken. This retention requirement goes beyond the application itself and also requires the credit union to retain the notification of action taken and, if applicable, the specific reasons for the adverse action. For consumer credit, credit unions are required to retain any adverse action notices for 25 months. For business credit, the retention requirement is 12 months.

RESEARCH TIP: **The CFPB's Supervision and Examination Manual contains a section on Regulation B that might be a useful resource to understand examiner expectations. The CFPB also issues an annual Fair Lending Report in addition to several related blog posts.**

LENDING DISCRIMINATION

Regulation B and section 701.31 of NCUA's rules prevent a credit union from discriminating based on the following prohibited bases: race or color; religion; national origin; sex; age; marital status; familial status; handicap; receipt of public assistance income and the prior assertion by an applicant of any right under the Consumer Credit Protection Act. The prohibited basis may not be known when the improper action is taking place. However, examiners and plaintiffs' attorneys may discover that credit applicants are being treated differently and then determine if a protected class of applicants is being harmed.

During the lending process, credit unions may not, because of a prohibited factor:

- Fail to provide information or services (or provide different levels of information or services) regarding any aspect of the lending process;
- Discourage or selectively encourage potential credit applicants;
- Refuse to extend credit or use different standards in determining whether to extend credit;
- Vary the terms of credit offered, including the amount, interest rate, duration or type of loan;
- Use different standards to evaluate collateral;
- Treat a borrower differently in servicing a loan or during a loan modification request; or
- Use different standards for packaging a loan in the secondary market.

These protections extend beyond just the credit applicant and include potential applicants, existing borrowers and other associated persons (such as co-applicant, spouse or business partner).

The overarching theme is that the credit union needs to treat all applicants similarly. The information and assistance an applicant receives from the credit union needs to be uniform to prevent fair lending issues. This extends to areas where exceptions are made from the credit union's normal policies. If exceptions are granted without a set framework, it could be an area examiners review more closely as it could be a situation where applicants in a protected class are not also being offered exceptions. In addition, a credit union that institutes an exception must be able to articulate a legitimate business reason for allowing such an exception.

MORE INFORMATION: For an update on trending fair lending exam issues, the federal banking agencies hold an annual "Interagency Fair Lending Hot Topics" webinar through the Federal Reserve's *Consumer Compliance Outlook Live*. The most recent webinar as well as archived versions from past years may be accessed here.

Types of Lending Discrimination

Courts have outlined three methods for proving lending discrimination, which are briefly discussed below. Fair lending and discrimination issues are very case-specific. However, the descriptions may help reinforce the overarching requirement that all members receive the same information and level of service from the credit union.

Overt Discrimination

Overt discrimination is established by looking at the lender's statements and policies for explicit actions that discriminate against a protected class. For example, if a credit union offered credit cards where the credit limit was determined solely by the gender of the applicant, it would be evidence of overt discrimination.

Comparative Evidence of Disparate Treatment

Disparate treatment can occur when a credit union treats applicants differently. This is, in part, because oftentimes applications are "close cases" and the credit decision could hinge on the level of assistance provided to the applicant during the application and credit approval process. Credit unions need to be sure that the information and assistance provided to applicants is uniform to prevent potential fair lending issues.

A protected class (race, color, national origin, religion, sex, handicap, familial status, source of income) could be discriminated against if the members of that class receive less assistance than other applicants or are not offered the same alternatives or potential for exceptions that are provided to other applicants. If the evidence indicates discrimination, the credit union can provide an explanation for the difference in treatment, although the final determination is for the examiners and, ultimately, the court system if a lawsuit is initiated.

Evidence of Disparate Impact

Disparate impact occurs when a neutral policy results in members of a protected class not obtaining the same level of service, access to information or credit as other members. The credit union will need to justify its policy by showing the legitimate business rationale for the policy and why another less discriminatory policy was not possible.

NAFCU NOTE

In September 2020, HUD issued a final rule to amend their interpretation of the Fair Housing Act's disparate impact standard in light of a court ruling. This NAFCU *Compliance Monitor* article provides additional information about the court ruling and the rule (member only).

An example of this type of discrimination would be a loan policy that included a minimum loan amount for home purchase loans. The credit union might have a minimum for legitimate business reasons (such as to sufficiently recoup its costs), but the policy could nevertheless prevent certain applicants from obtaining a loan at the credit union because their property value falls below the minimum loan amount. If this unintended consequence impacts a protected class in a disproportionate manner, this policy could be further examined by NCUA for fair lending concerns to determine if another policy could fulfill the credit union's business reasons without the discriminatory impact.

MORE INFORMATION: The CFPB will be focusing on identifying, prohibiting, and prosecuting discrimination as unfair, deceptive and abusive acts and practices (UDAAPs) in consumer finance, as a whole. This CFPB Newsroom post discusses changes to the CFPB's supervisory operations that "better protect families and communities from illegal discrimination, including in situations where fair lending laws may not apply." Of note, the CFPB stated that "discrimination may meet the criteria for 'unfairness' by causing substantial harm to consumers that they cannot reasonably avoid, where that harm is not outweighed by countervailing benefits to consumers or competition." Here is a link to the updated exam manual on unfair, deceptive or abusive acts or practices.

NCUA'S NON-DISCRIMINATION IN REAL ESTATE REGULATION

NCUA has a specific regulation, section 701.31, which requires nondiscrimination in real estate lending. This regulation applies only to federal credit unions; however, state-chartered credit unions should look to state law for similar restrictions. A real estate-related loan is defined in section 701.31(a)(3) as "any loan for which application is made to finance or refinance the purchase, construction, improvement, repair or maintenance of a dwelling."

Nondiscrimination in Lending

Federal credit unions cannot discourage an application, discriminate in setting the terms or conditions or deny a real estate-related loan on a prohibited basis. Federal credit unions are prohibited from taking discriminatory action based on the following: race; color; national origin; religion; sex; handicap or familial status (having children under the age of 18).

This prohibition extends not only to the loan applicant but also any joint applicants; any persons associated with the applicant(s) and any present or prospective owners, lessees, tenants or occupants of the dwelling or other nearby dwellings. In short, the prohibition extends past the underlying applicant(s) if a third-party could prove in court it was harmed by the federal credit union's discriminatory actions.

Federal credit unions are also specifically prohibited from considering the following factors in real estate-related loans:

- The age or location of the dwelling;
- Zip code of the applicant's current residence;
- Previous home ownership;
- The age or location of dwellings in the neighborhood; and
- The income level of residents in the neighborhood.

Section 701.31(e) indicates that location factors are prohibited to prevent abandonment of areas where members live or want to live (similar to "redlining" where a financial institution abstains from lending in certain areas). However, the prohibition does not require federal credit unions to make loans in areas that are geographically remote from the credit union's branches or outside of its charter.

Nondiscrimination in Real Estate Advertising

Federal credit unions must include a nondiscrimination disclosure on any advertising for real estate-related loans. The disclosure – which applies to printed, oral, online and TV ads – must indicate that the credit union makes loans in a nondiscriminatory manner. Section 701.31(d) of NCUA's regulations sets out the requirements and safe harbor language.

For printed or online ads, credit unions can meet the requirements by including the Equal Housing Logo with either the words "Equal Housing Lender" or "Equal Housing Opportunity." For oral ads, the credit union can use either statement: "Equal Housing Lender" or "Equal Opportunity Lender." For video ads, the credit union can follow either the rules for the printed/online ads or the rules for oral ads. However, both disclosures are not required for video ads.

In addition, any federal credit union that originates real estate loans must display a notice of nondiscrimination. The notice must be displayed in the lobby of the credit union and in the public area of offices where real-estate loans are made. Credit unions can use the Equal Housing Lender poster to meet this requirement.

POTENTIAL UNFAIR LENDING PRACTICES

Dodd-Frank repealed NCUA's "unfair or deceptive" rulemaking authority under the Federal Trade Commission Act. Despite this repeal, NCUA still has supervisory and enforcement authority regarding unfair or deceptive acts or practices so the practices that were previously prohibited by NCUA's credit practices rule may still be deemed to be unfair or deceptive. This section highlights practices that NCUA has previously indicated may be unfair or deceptive.

Notice to Cosigner

NCUA's former credit practices rule required that federal credit unions provide a cosigner with a disclosure about their potential liability on a loan prior to the extension of credit (which for open-end lending means prior to the time that the agreement creating the cosigner's liability for future charges is signed).

NAFCU NOTE

For more on the prohibitions under NCUA's credit practices rule, check out this NAFCU *Compliance Blog* post.

Prior to its repeal, the credit practices rule defined a cosigner as "a natural person who renders himself or herself liable for the obligation of another person without receiving goods, services or money in return for the credit obligation or, in the case of an open-end credit obligation, without receiving the contractual right to obtain extensions of credit under the obligation." Unlike a co-borrower or co-maker on a loan, the cosigner is not jointly liable for the debt and does not have legal rights to the property purchased with the proceeds of the loan. Rather, the cosigner (or guarantor) is secondarily liable for the debt – meaning the federal credit union can attempt to collect from the cosigner if the primary borrower(s) defaults.

Because the repealed rule prohibited misrepresentation of the nature or extent of the cosigner's potential liability, this is likely to be considered a UDAAP under the CFPB's enforcement authority. Under NCUA's former rule, federal credit unions were required to provide cosigners with a disclosure prior to becoming obligated to ensure cosigners received an accurate description. Here is the disclosure NCUA required prior to the repeal:

> *"NOTICE TO COSIGNER*
>
> *You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.*
> *You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.*
>
> *The creditor can collect this debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become a part of your credit record.*
>
> *This notice is not the contract that makes you liable for the debt."*

While no longer required by regulation, federal credit unions could continue to use this disclosure to reduce the risk of misrepresenting the nature or extent of the cosigner's liability.

Pyramiding of Late Fees in Consumer Credit

Another potentially unfair or deceptive practice is the "pyramiding of late fees" on consumer credit. The credit practices rule prohibited federal credit unions from charging a second late payment fee if the only amount left outstanding after a payment is a prior late fee. For example, a member with a $50 monthly payment makes the June payment late incurring a $20 late fee. If the member makes a $50 July payment on time but without paying the $20 late fee from the June payment, the FCU could not charge a second late fee to the member. This result holds even if the FCU applies part of the July payment toward the $20 late fee.

MORE INFORMATION: The pyramiding of late fees for consumer credit secured by a dwelling is expressly prohibited by Regulation Z at 12 CFR § 1026.36(c)(2). This is discussed further in Section 9 of this chapter.

NCUA Legal Opinion Letter 00-0101 states "[o]nly if a timely payment is insufficient to satisfy outstanding principal and interest obligations may the FCU assess an additional late charge." Therefore, in this example the $50 July payment was sufficient to cover the outstanding principal and interest and a second late fee would likely result in a violation of UDAAP. While Legal Opinion Letter 00-0101 analyzed a provision of the credit practices rule, credit unions should continue to refrain from pyramiding late fees as NCUA retains supervisory and examination authority for unfair and deceptive practices.

CHAPTER 3 — LENDING

SECTION 12 — THE FAIR CREDIT REPORTING ACT

OVERVIEW

The Fair Credit Reporting Act (FCRA), 15 USC §1681, et seq, and its related regulation, Regulation V, create a massive framework of rules that govern the assembly, collection, use and sharing of consumer report information. The CFPB has the primary interpretive and enforcement role with respect to the FCRA, but it is also enforced by the federal financial regulators, including NCUA, state regulators, and through private litigation.

Due to the scope of the subject matter, this section will not dive into every area of FCRA compliance, such as the use of consumer reports for employment purposes. The FCRA also contains significant responsibilities for business entities that are consumer reporting agencies which will not be covered in this section.

In addition to the requirements related to consumer reporting agencies, FCRA requirements also apply to financial institutions that operate in any of the following capacities:

- Users of information (for example, as credit grantors or when opening share accounts);
- Furnishers and transmitters of information (by reporting information to consumer reporting agencies, other third parties or to affiliates);
- Marketers of credit or insurance products; and
- Employers.

RESEARCH TIP: The FTC's Report 40 Years of Experience with the Fair Credit Reporting Act contains useful guidance and general impressions from FTC staff covering every provision of the FCRA. While not binding guidance, it may provide a useful interpretation. The FTC's FCRA Advisory Opinions can also be informative.

CONSUMER REPORTS AND CONSUMER REPORTING AGENCIES

Whether the requirements of the FCRA apply to a situation depends in large part on whether the information being shared meets the definition of a consumer report and whether the organization sharing information meets the definition of a consumer reporting agency. Both terms are defined in sections 603(d) and (f) of the FCRA.

Definition of a Consumer Report

A consumer report is any written, oral or other communication of any information by a consumer reporting agency that bears on a consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living that is used, expected to be used or collected for the purpose of serving as a factor in establishing the consumer's eligibility for any of the following:

- Credit or insurance to be used primarily for personal, family or household purposes;
- Employment purposes; or
- Any other purpose authorized under the FCRA.

While the definition of consumer report usually brings to mind a credit report, the definition is broad enough to cover other reports, such as a ChexSystems report.

The term consumer report does not include any of the following:

- Any report containing information solely about transactions or experiences between the member and the credit union making the report;
- Any communication of that transaction or experience information among entities related by common ownership or affiliated by corporate control (for example, a credit union's CUSO); or
- Communication of other information among persons related by common ownership or affiliated by corporate control if:
  - It is clearly and conspicuously disclosed to the consumer that the information may be communicated among such persons; and
  - The consumer is given the opportunity, before the time that the information is communicated, to direct that the information is not communicated among such persons (i.e., opt out).

Definition of a Consumer Reporting Agency

A consumer reporting agency is defined as any person which, for fees, dues, or on a cooperative basis, regularly engages in the practice of assembling or evaluating credit information on consumers for the purpose of furnishing consumer reports to third parties. Generally, a credit union is not a consumer reporting agency; however, depending on the degree to which its information sharing practices approximate those of a consumer reporting agency, it can be deemed as such. The CFPB maintains a list of consumer reporting agencies that is updated annually.

Sharing Information Without Becoming a Consumer Reporting Agency

Remember that a consumer report can include information about a consumer that bears on their creditworthiness, character and capacity, among other factors. Communication of this information could cause a financial institution to become a consumer reporting agency. The statutory definition of consumer report contains key exemptions to this definition that enable financial institutions to share this type of information under certain circumstances, without becoming consumer reporting agencies. It is important for credit unions to navigate these rules accurately, as the regulatory burdens for consumer reporting agencies are extreme. Specifically, the term consumer report does not include:

- A report containing information solely as to transactions or experiences between the member and the credit union making the report. A credit union may share information strictly related to its own transactions or experiences regarding a member (such as the member's payment history or an account with the credit union) with any third party without becoming a consumer reporting agency. Keep in mind Regulation P may restrict this type of information sharing. Therefore, sharing it with nonaffiliated third parties may be subject to an opt-out under Regulation P.
- Communication of such transaction or experience information among financial institutions related by common ownership or affiliated by corporate control. For credit unions, this would be referring to CUSOs.
- Communication of other information (for example, other than transaction or experience information) among persons and financial institutions related by common ownership or affiliated by corporate control, if it is disclosed to the consumer and the consumer is given a chance to opt out before the information is initially communicated. This allows a financial institution to share other information (that is, information other than its own transaction and experience information) that could otherwise be a consumer report, without becoming a consumer reporting agency if:
  - The sharing of the other information is done with affiliates; and
  - Consumers are provided with the notice and an opportunity to opt out of this sharing before the information is first communicated among affiliates.

MORE INFORMATION: The FCRA defines a consumer as an individual person. For the purposes of this chapter, each reference to a member will refer to a credit union member who is an individual.

OBTAINING AND USING CONSUMER REPORTS

Consumer reporting agencies have a significant amount of personal information about consumers. This information is invaluable in assessing a consumer's creditworthiness for a variety of products and services, including loan and share accounts. The FCRA governs access to this information to ensure that a prospective user of the information obtains it for permissible purposes and does not exploit it for illegitimate purposes.

The FCRA permits a consumer reporting agency to furnish any prospective user, including credit unions, with a consumer report only if the user has a legally permissible purpose to obtain the report. The user must certify to the consumer reporting agency that it has a permissible purpose before the report is furnished.

Permissible Purposes of Consumer Reports

Legally Permissible Purposes. Section 604 of the FCRA allows a consumer reporting agency to furnish a consumer report for a number of permissible purposes, including the following:

- In accordance with the written instructions of the consumer; or
- To a person, including a credit union, that the consumer reporting agency has reason to believe intends to use the report as information for any of the following reasons:
  - In connection with a credit transaction involving the consumer (including extending, reviewing and collecting credit);
  - For employment purposes;
  - In connection with the underwriting of insurance involving the consumer;
  - As a potential investor or servicer, or current insurer, in connection with a valuation of, or an assessment of the credit or prepayment risks associated with an existing credit obligation; or
  - Otherwise has a legitimate business need for the information:
  - In connection with a business transaction that the consumer initiates; or
  - To review an account to determine whether the consumer continues to meet the terms of the account.

As this section points out, credit unions do not need a member's express consent to pull their credit report in every situation. However, credit unions do need a permissible purpose before a consumer reporting agency may provide the credit union with a consumer report in every situation.

Prescreened Consumer Reports. Under section 604(c) of the FCRA, consumer reports can only be furnished in connection with credit transactions that are not initiated by a member if the user of the consumer report, such as a credit union, complies with the prescreen requirements. Credit unions may obtain prescreened consumer reports to make firm offers of credit or insurance to members, unless the members elected to opt out of being included on prescreened lists. The FCRA contains many requirements, including an opt-out notice requirement when prescreened consumer reports are used. Prescreened consumer reports will be discussed later in this section.

Using Consumer Reports

The FCRA prohibits use of a consumer report for any purpose other than the permissible purpose which was certified to the consumer reporting agency. For example, if a member applies for credit, and a consumer report is obtained by a credit in connection with a credit application submitted by the member, the credit union would only be able to use that report in connection with that transaction. The report could not then be used for cross-selling of other products. For this reason, many credit unions will try to obtain and certify as the permissible purpose the member's written instructions to obtain a consumer report for a broader scope of activities, including marketing.

Certain types of information or uses trigger additional requirements. For example, there is a general prohibition against using medical information in connection with a determination of a consumer's eligibility for credit, unless the financial information exception is met. Subpart D of Regulation V contains additional information, including additional exceptions regarding the use of medical information. Further, when reviewing a report in connection with employment purposes, special notices and disclosures are required. Credit unions encountering these issues may wish to consult the FCRA and Regulation V for more information.

DISCLOSURES TO CONSUMERS

Prescreened Consumer Reports and Opt-Out Notice

The FCRA allows credit unions to obtain and use consumer reports on any member in connection with any credit transaction that the member does not initiate to make firm offers of credit. This process, known as prescreening, occurs when a credit union obtains a list from a consumer reporting agency of members who meet certain predetermined creditworthiness criteria and who have not elected to be excluded from such lists.

Under section 604(c), these lists may only contain the following information:

- The name and address of a member;
- An identifier that is not unique to the member and that the credit union uses solely for the purpose of verifying the identity of the member; and
- Other information pertaining to a member that does not identify the relationship or experience of the member with respect to a particular creditor or other entity.

NAFCU NOTE

This NAFCU *Compliance Monitor* article provides answers to common questions regarding various prescreened marketing practices (member only).

Each name appearing on the list is considered an individual consumer report. In order to obtain and use these lists, credit unions must make a firm offer of credit or insurance to each person on the list. The firm offer of credit cannot be conditioned on the member further qualifying, with a few exceptions. A credit union is not required to grant credit if the credit union established a requirement for collateral before obtaining the list, the collateral requirement is disclosed in the offer and the member cannot furnish the required collateral.

In addition, the credit union is allowed to obtain a consumer report on anyone responding to the offer to verify that the member continues to meet the creditworthiness criteria. If the member no longer meets those criteria, the credit union does not have to grant the loan. In addition, the credit union is allowed to verify the information contained in the credit application and consumer report.

These basic requirements help prevent credit unions from obtaining prescreened lists without following through with an offer of credit or insurance. The credit union must maintain the criteria used for the product (including the criteria used to generate the prescreened report and any other criteria such as collateral requirements) on file for a period of three years, beginning on the date that the credit union made the offer to the member.

Technical Notice and Opt-Out Requirements. The FCRA requires nationwide consumer reporting agencies to jointly operate an opt-out system, through which consumers can elect to be excluded from prescreened lists by calling a toll-free number.

Short and Long Notice. Section 1022.54 of Regulation V requires credit unions to give a short notice and a long notice of the prescreened opt-out information with each written solicitation made to members using prescreened consumer reports. These regulations also contain specific requirements concerning the content and appearance of these notices.

MORE INFORMATION: Appendix D to Regulation V provides model long and short notices that comply with the requirements of section 1022.54 for prescreened offers of credit.

Disclosure of Credit Scores by Certain Mortgage Lenders

Section 609(g) requires credit unions that make or arrange mortgage loans using credit scores to provide the score with accompanying information to the applicants. The disclosure requirement applies to covered transactions, which include both closed-end and open-end loans that are for consumer purposes and are secured by one- to four-family residential real property, including purchase and refinance transactions. This requirement will not apply in circumstances that do not involve a consumer purpose, such as when a member obtains a loan secured by his or her residence to finance his or her small business.

Credit unions that use credit scores in covered transactions must provide a disclosure containing the name, address and telephone number of each consumer reporting agency that provided a credit score that was used. For specific language, review the model language in Appendix H to Regulation V. These model forms incorporate the language required by section 609(g)(1)(D) of the FCRA.

Credit Score and Key Factors Disclosed. In addition to the notice, credit unions must also disclose the credit score, the range of possible scores, the date that the score was created and the key factors used in the score calculation. Key factors are all relevant elements or reasons adversely affecting the credit score for the particular member, listed in the order of their importance, and based on their effect on the credit score. Generally, the total number of factors the financial institution should disclose must not exceed four.

This disclosure requirement applies in any application for a covered transaction, regardless of the final action the credit union takes on the application. The FCRA requires a credit union to disclose all of the credit scores used in these transactions. For example, if two joint applicants apply for a mortgage loan to purchase a single-family residence and the credit union uses both credit scores, then the credit union needs to disclose both. The statute specifically does not require more than one disclosure per loan. Therefore, if the credit union uses multiple scores, it can include all of them in one disclosure containing the Notice to the Home Loan Applicant.

Timing. A credit union must provide the notice as soon as is reasonably practicable after using a credit score.

Adverse Action Notices

Definition of an Adverse Action. The term adverse action has the same meaning as used in the ECOA and Regulation B. Under the ECOA, adverse action means a denial or revocation of credit, a change in the terms of an existing credit arrangement or a refusal to grant credit in substantially the same amount or on terms substantially similar to those requested. The term *does not* include a refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or otherwise in default, or where such additional credit would exceed a previously established credit limit. It also *does not* include a counteroffer that the member expressly accepts or uses.

For purposes of the FCRA, the term has four additional meanings. One of those additional meanings is important to note as it can include applications for deposit products:

- An action taken or determination that is:
  - Made in connection with an application made by or transaction initiated by any member, or in connection with a review of an account to determine whether the member continues to meet the terms of the account; and
  - Adverse to the interests of the member.

MORE INFORMATION: This Federal Reserve *Consumer Compliance Outlook* article compares the adverse action notice requirements under the FCRA and Regulation B in a comprehensive fashion and may be helpful in understanding the nuances of each.

The FCRA's adverse action notice requirements have no implementing regulation. In order to comply with the FCRA's adverse action notice requirements, credit unions may use model forms C-1 through C-5 included in Appendix C to Regulation B, which implements the ECOA. Moreover, specific disclosures are required depending upon whether the source of the information is: a consumer reporting agency; a third party other than a consumer reporting agency; or an affiliate. The disclosure requirements are discussed separately below.

Information Obtained From a Consumer Reporting Agency

Under section 615(a), when adverse action is taken with respect to any member based in whole or in part on any information obtained from a consumer reporting agency, the credit union must provide:

- Oral, written or electronic notice of the adverse action to the member;
- The numerical credit score used in making the decision;
- The range of possible scores under the model used;
- Key factors that adversely affected the credit score of the member;
- The date on which the credit score was created; and
- The name of the person or entity that provided the score.
- Orally, in writing or electronically:
  - The name, address and telephone number of the consumer reporting agency from which it received the information (including a toll-free telephone number established by the agency, if the consumer reporting agency maintains files on a nationwide basis); and
  - A statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide the member the specific reasons why the adverse action was taken;
- An oral, written or electronic notice of the member's right to obtain a free copy of the consumer report from the consumer reporting agency within 60 days of receiving notice of the adverse action, and the member's right to dispute the accuracy or completeness of any information in the consumer report with the consumer reporting agency.

MORE INFORMATION: The FCRA's adverse action requirements are not limited to credit products. If a consumer report is used to deny a member's request for a debit card or checking account, the FCRA's adverse action requirements would apply.

Information Obtained From an Affiliate

If a credit union takes an adverse action involving credit (taken in connection with a transaction initiated by a member) based in whole or in part on information provided by an affiliate, section 615(b)(2) requires the credit union to do two things. The notification must inform the member of the action and that the member may obtain a disclosure of the nature of the information relied upon by making a written request within 60 days of transmittal of the adverse action notice. If the member makes such a request, the user must disclose the nature of the information received from the affiliate no later than 30 days after receiving the request.

MORE INFORMATION: This FCRA provision would also be relevant to the extent the credit union takes adverse action against an individual in the employment context.

Information Obtained From a Source Other Than a Consumer Reporting Agency

There are also adverse action disclosure requirements under 615(b)(1) if a credit union denies credit for personal, family or household purposes involving a member or increases the charge for credit, and that decision was made partially or wholly using information obtained from a person other than a consumer reporting agency. This is not a common practice. If the credit union uses third-party information in this way, understand that certain disclosure requirements exist.

Risk-Based Pricing Notifications

Section 1022.72 of Regulation V requires a user of consumer reports to provide a risk-based pricing notice to a consumer when the user, based on a consumer report, extends credit to the consumer on terms that are “materially less favorable” than the terms the financial institution has extended to other consumers.

A credit union that does this must provide members with a risk-based pricing notice in the form and manner prescribed by Subpart H of Regulation V if:

- The credit union uses a consumer report in connection with an application for, or a grant, extension or other provision of, credit to a member for personal, family or household purposes; and
- Based in whole or in part on the consumer report, the credit union grants, extends or otherwise provides credit to that member on material terms that are materially less favorable than the most favorable material terms available to a substantial proportion of the credit union’s members.

NAFCU NOTE

For more details on the risk-based pricing notice requirements, take a look at this NAFCU *Compliance Monitor* article (member only). It also includes a number of questions and answers to related issues.

Section 615(h) requires that the risk-based pricing notice include any credit score that was used in making a credit decision. Specifically, the notice must also disclose:

- A statement advising the member that the credit terms offered are based on information from a consumer report;
- The numerical credit score used in making the decision;
- The range of possible scores under the model used;
- Key factors that adversely affected the member's credit score;
- The date on which the credit score was created;
- The name of the person or entity that provided the score, and the person's contact information; and
- A statement that the member can obtain a copy of the consumer report without charge from the person that supplied the consumer report to the credit union;

The creditor to whom the obligation is initially payable (i.e., the original creditor) must provide the notice.

The requirements surrounding risk-based pricing notices are extremely complicated. Who receives the notice, the timing of notice and whether a credit union wishes to use one of a number of exceptions to the general rule all hinge on a number of variables. Credit unions wishing to dive into the requirements in this area are urged to review Subpart H of Regulation V. Appendix H of the regulation provides model risk-based pricing forms.

Affiliate Marketing Notice and Opt-Out

Under the FCRA, an entity may not use consumer report information received from an affiliate to market its products or services to a member, unless the member is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations. The affiliate marketing opt-out applies to both transaction or experience information and other information, such as information from credit reports and credit applications.

MORE INFORMATION: The Privacy section in Chapter 4, Section 2 provides more on the affiliate marketing rules. Also, check out Chapter 7 of NAFCU's ***Credit Union Compliance Advertising Guide*** (member-only).

DUTIES OF FURNISHERS OF CONSUMER REPORT INFORMATION

There is no federal requirement that compels credit unions to furnish information to a consumer reporting agency. Whether a credit union chooses to furnish information to some or all of the major credit reporting agencies is a business decision for each credit union to make, though there may be contractual obligations to do so. If a credit union does furnish information regarding its members to a consumer reporting agency, it must do so in compliance with the FCRA, Regulation V and its agreement with that consumer reporting agency.

Reasonable Policies and Procedures Concerning the Accuracy and Integrity of Furnished Information

Section 1022.42 requires each furnisher (including credit unions that furnish information to a consumer reporting agency) to have reasonable written policies and procedures regarding the accuracy and integrity of consumer information that it furnishes to a consumer reporting agency. The policies and procedures must be appropriate to the nature, size, complexity and scope of each furnisher's activities. In addition, the policies and procedures must take into consideration furnishing information to all types of consumer reporting agencies, including specialty agencies such as those that aggregate consumer deposit account information.

MORE INFORMATION: The CFPB's Bulletin 2016-01 discusses the requirement to implement reasonable written policies to ensure the accuracy and integrity of information furnished to consumer reporting agencies.

In developing its policies and procedures, a furnisher must consider the Interagency Guidelines and may include those guidelines that are relevant and appropriate in its existing policies and procedures. Each furnisher must also review its policies and procedures periodically and update them as necessary to ensure their continued effectiveness.

The guidelines include the following recommendations:

- Using standard data reporting formats and standard procedures for compiling and furnishing data, where feasible, such as electronic transmission of information about members to consumer reporting agencies;
- Maintaining records for a reasonable period of time, not less than any applicable recordkeeping requirement, in order to substantiate the accuracy of any information furnished about members to consumer reporting agencies that is subject to a direct dispute; and
- Training staff that participates in activities related to the furnishing of information about members to consumer reporting agencies.

The guidelines also include several other factors not listed above that policies and procedures should address.

Duties Upon Notice of Dispute From a Consumer Reporting Agency

Section 623(b) of the FCRA sets forth certain obligations that furnishers have upon receipt of a notice of dispute from a consumer reporting agency. Whenever a credit union receives such a notice disputing the accuracy or completeness of information that was provided to a consumer reporting agency, that credit union must:

- Conduct an investigation regarding the disputed information;
- Review all relevant information the consumer reporting agency provided, along with the notice of dispute;
- Report the results of the investigation to the consumer reporting agency;

- If the investigation finds the information is incomplete or inaccurate, report those results to all nationwide consumer reporting agencies to which the credit union previously provided the information; and
- If the disputed information is incomplete, inaccurate or not verifiable by the credit union, it must promptly, for purposes of reporting to the consumer reporting agency do one of the following:
  - Modify the item of information;
  - Delete the item of information; or
  - Permanently block the reporting of that item of information.

The credit union must complete the required investigations, reviews and reports within 30 days. The credit union may extend the time period for 15 days if a consumer reporting agency receives additional relevant information from the member.

NAFCU NOTE

For more on furnishers' responsibilities under the FCRA, see this NAFCU Compliance Monitor article (member only).

Duties Upon Notice of Dispute From a Consumer (Direct Disputes)

When a credit union that furnishes information to consumer reporting agencies receives a notice of dispute directly from a member, this is called a direct dispute. Under section 1022.43(a), a credit union under those circumstances must conduct a reasonable investigation of direct disputes if the dispute relates to:

- The member's liability for a credit account or other debt with the credit union, such as direct disputes relating to whether there is or has been identity theft or fraud against the member;
- The terms of a credit account or other debt with the credit union, such as, direct disputes relating to the principal balance, scheduled payment amount or the amount of the credit limit;
- The member's performance on an account; or
- Any other information contained in a consumer report regarding an account or other relationship with the credit union that bears on the member's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living.

Exceptions. The direct dispute requirements do not apply in a number of situations outlined in section 1022.43(b), including if the direct dispute relates to:

- The member's identifying information such as name, date of birth or address;
- Inquiries or requests for a consumer report;
- Information derived from public records, such as judgments, bankruptcies, liens and other legal matters (unless the information was provided by a furnisher with an account or other relationship with the member);
- Information related to fraud alerts or active duty alerts; or
- Information provided to a consumer reporting agency by another furnisher.

The direct dispute requirements also do not apply if the credit union has a reasonable belief that the direct dispute is:

- Submitted by a credit repair organization;
- Is prepared on behalf of the member by a credit repair organization; or
- Is submitted on a form supplied to the member by a credit repair organization.

Direct Dispute Address. According to section 1022.43(c), a credit union is required to investigate a direct dispute only if a member submits a dispute notice to the credit union at:

- The address provided by a credit union and listed on a consumer report relating to the member;
- An address specified by the credit union, provided to the member in writing; or
- Any business address of the credit union if the credit union has not provided a specific address for submitting direct disputes.

MORE INFORMATION: For further analysis on the federal regulators' expectations regarding investigating disputes, check out CFPB Bulletin 2014-01 and this NAFCU blog post regarding a CFPB Circular.

Direct Dispute Notice Contents. Section 1022.43(d) provides the criteria that is sufficient to constitute a dispute notice from a member, which must include:

- Sufficient information to identify the account that is in dispute;
- The specific information that the member is disputing and an explanation of the basis for the dispute; and

- All supporting documentation or other information reasonably required by the credit union that furnished the disputed information to substantiate the basis of the dispute. This documentation may include, for example: a copy of the relevant portion of the consumer report that contains the allegedly inaccurate information; a police report; a fraud or identity theft affidavit; a court order; or account statements.

Duties of a Furnisher After Receiving a Direct Dispute Notice From a Consumer. A furnisher's responsibilities for responding to direct disputes are similar to what is required after receiving a dispute notice from a consumer reporting agency.

After receiving a dispute notice from a member, section 1022.43(e) requires the credit union to:

- Conduct a reasonable investigation with respect to the disputed information;
- Review all relevant information provided by the member with the dispute;
- Complete its investigation of the dispute and report the results of the investigation to the member within 30 days, with a possible 15-day extension; and
- If the investigation finds that the information reported was inaccurate, promptly notify each consumer reporting agency to which the credit union provided inaccurate information of investigation findings and provide to the consumer reporting agency any correction to that information that is necessary to make the disputed information accurate.

Frivolous or Irrelevant Disputes. A credit union is not required to investigate a direct dispute if it has reasonably determined that the dispute is frivolous or irrelevant. A dispute generally qualifies as frivolous or irrelevant if:

- The member did not provide sufficient information to investigate the disputed information; or
- The direct dispute is substantially the same as a dispute previously submitted by (or on behalf) of the member and if the credit union already complied with the regulatory requirements for that earlier dispute.

When making a determination that a dispute is frivolous or irrelevant under section 1022.43(f), a credit union must notify the member of that determination no later than five business days after making the determination, by mail or, if authorized by the member, by any other means available to the credit union. The notice that a dispute is frivolous or irrelevant must include the reasons for that determination and identify any information required to investigate the disputed information. The notice may consist of a standardized form.

NAFCU NOTE

For further information on managing frivolous disputes, have a look at this NAFCU *Compliance Blog* post.

Prevention of Re-Pollution of Consumer Reports

The FCRA has specific requirements for furnishers of information that receive notice from a consumer reporting agency that furnished information may be fraudulent as a result of identity theft. Specifically, section 605B(b) of the FCRA requires consumer reporting agencies to notify furnishers of information that: the information may be the result of identity theft; an identity theft report has been filed; and that a block has been requested.

Upon receiving such notice, the section 623(a)(6) of the FCRA requires credit unions to establish and follow reasonable procedures to ensure that it does not re-report this information to the consumer reporting agency (i.e., re-polluting the victim's consumer report).

Negative Information Notice

Section 623(a)(7) of the FCRA requires a credit union to provide members with a notice either before it provides negative information to a nationwide consumer reporting agency, or within 30 days after reporting the negative information.

Negative Information. For these purposes, negative information means any information concerning a member's delinquencies, late payments, insolvency or any form of default.

Credit unions may provide this disclosure on or with any notice of default, any billing statement or any other materials provided to the member. Credit unions may also choose to provide this notice to all members in an abundance of caution. However, credit unions may not include this notice in the initial Regulation Z disclosures for open-end credit.

Model Text. Appendix B to Regulation V contains model text that credit unions can use to comply with these requirements. The first model contains text a credit union can use when it provides a notice before furnishing negative information. The second model form contains text to use when a credit union provides notice within 30 days after reporting negative information:

> *Notice Prior to Communicating Negative Information (Model B-1):*
>
> *"We may report information about your account to credit bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report."*
>
> *Notice Within 30 Days After Communicating Negative Information (Model B-2):*
>
> *"We have told a credit bureau about a late payment, missed payment, or other default on your account. This information may be reflected in your credit report."*

Use of the model forms is not required; however, proper use of the model forms provides a credit union with a safe harbor from liability. The submission of additional negative information to a consumer reporting agency with respect to the same transaction, extension of credit, account, or member does not require additional notice.

CONSUMER ALERTS AND IDENTITY THEFT PROTECTIONS

In 2003, in an effort to protect consumers from identity theft, the FACT Act added several provisions to the FCRA. These provisions contain requirements for both consumer reporting agencies and users of consumer reports that are designed to help prevent identity theft and mitigate its harm to consumers.

Truncation of Credit and Debit Card Account Numbers

Section 605(g) prohibits persons that accept debit and credit cards from issuing electronic receipts that contain more than the last five digits of the card number or the card expiration date at the point of sale or transaction. This requirement applies only to electronically developed receipts and does not apply to hand-written receipts or those developed with an imprint of the card.

Notice of Address Discrepancies

When providing a consumer report to a credit union, the FCRA requires that a nationwide consumer reporting agency (NCRA) provide a notice of an address discrepancy if the address provided by the credit union in its request "substantially differs" from the address the NCRA has in the member's file. These requirements are located in section 1022.82 of Regulation V.

The receipt of a notice of address discrepancy is a red flag that should trigger a credit union's identity theft protection program. The FCRA requires credit unions to establish a program to detect, prevent and mitigate identity theft.

MORE INFORMATION: The red flags rule is addressed in further detail in Section 5 of the Appendix.

Fraud and Active-Duty Alerts

Initial Fraud and Active-Duty Alerts. Consumers who suspect that they may be the victims of fraud, including identity theft, may request the NCRAs to place initial fraud alerts in their consumer reports. These alerts must remain in a consumer's report for no less than one year. In addition, members of the armed services who are called to active duty may also request that active-duty alerts be placed in their consumer reports. Active-duty alerts must remain in these servicemembers' files for no less than 12 months.

Section 605A requires a credit union to verify a member's identity if a consumer report it receives includes a fraud or active-duty alert. Unless the credit union uses reasonable policies and procedures to form a reasonable belief that it knows the identity of the member making the request, the credit union may not:

- Establish a new credit plan or extension of credit (other than under an open-end credit plan) in the name of the member;
- Issue an additional card on an existing account; or
- Increase a credit limit.

Extended Alerts. Consumers who allege that they are the victim of an identity theft may also place an extended alert that lasts seven years on their consumer report. Extended alerts require consumers to submit identity theft reports and appropriate proof of identity to the NCRAs.

The FCRA requires a credit union that obtains a consumer report that contains an extended alert to contact the member in person or by the method the member lists in the alert prior to performing any of the three actions listed above.

Information Available to Victims

Section 609(e) requires a credit union to provide records of fraudulent transactions to victims of identity theft within 30 days after the receipt of a request for the records. These records include the application and business transaction records under the control of the credit union, whether maintained by the credit union or another person such as a service provider.

The credit union should provide this information to any of the following:

- The victim;
- Any federal, state or local government law enforcement agency or officer specified by the victim in the request; or
- Any law enforcement agency investigating the identity theft that was authorized by the victim to take receipt of these records.

The victim must make the request for the records in writing and send it to the credit union at the address specified by the credit union for this purpose. The credit union may ask the victim to provide information, if known, regarding the date of the transaction or application, and any other identifying information such as an account or transaction number.

Unless the credit union has a high degree of confidence that it knows the identity of the victim making the request for information, the credit union must take prudent steps to positively identify the person before disclosing any information. Proof of identity can include any of the following:

- A government-issued identification card;
- Personally identifying information of the same type that was provided to the credit union by the unauthorized person; or
- Personally identifiable information that the credit union typically requests from new applicants or for new transactions.

At the election of the credit union, the victim must also provide proof of an identity theft complaint, which may consist of a copy of a police report evidencing the claim of identity theft and a properly completed affidavit. The affidavit can either be the standardized affidavit form prepared by the Federal Trade Commission (FTC), or an "affidavit of fact" that is acceptable to the credit union for this purpose. When these conditions are met, the credit union must provide the information at no charge to the victim.

The credit union is not required to provide any information if, acting in good faith, it determines any of the following:

- The credit union does not have a high degree of confidence in knowing the true identity of the requestor, based on the identification and/or proof provided;
- The request for information is based on a misrepresentation of fact by the requestor; or
- The information requested is internet navigational data or similar information about a person's visit to a web site or online service.

CHAPTER 3 — LENDING

SECTION 13 — LOANS IN FLOOD HAZARD AREAS

OVERVIEW

Flood regulations and the National Flood Insurance Program (NFIP) implement the National Flood Insurance Act of 1968, the Flood Disaster Protection Act of 1973 (FDPA), and the National Flood Insurance Reform Act of 1994. This framework has been amended several times through the years, most recently by the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters) and the Homeowner Flood Insurance Affordability Act, which was passed in 2014.

NCUA's flood regulations are located at Part 760 and require credit unions to make borrowers purchase flood insurance for loans secured by improved real estate or mobile homes that are located in special flood hazard areas (SFHAs) if the community where the improved real estate or mobile home is located participates in the NFIP. Where flood insurance is required, most credit unions are also required to escrow premiums and fees to pay for flood insurance and may be required to force place insurance under certain circumstances.

The NFIP makes federally subsidized flood insurance available to owners of improved real estate or mobile homes that are located in SFHAs if the community where the improved real estate or mobile home is located participates in the NFIP. A community participates in the NFIP by adopting and enforcing floodplain management measures and by making substantial improvements within its SFHAs to eliminate or minimize future flood damage.

The Federal Emergency Management Agency (FEMA) administers the NFIP, determines which communities are in a SFHA and develops flood maps. The SFHAs can be seen on FEMA's flood maps and have a one percent or greater chance of being flooded in any given year. If a borrower disagrees with the placement of the property in question in a SFHA, he or she may request a review from FEMA.

RESEARCH TIP: FEMA's **website** is a great resource for flood insurance information – including specific information regarding **insurance rules and legislation**.

NCUA, along with other regulators, finalized a rule in 2019 addressing the private flood insurance provisions of Biggert-Waters. The rule, in part, requires credit unions to accept private flood insurance policies for properties located in flood hazard areas if the policy meets certain conditions. The rule also establishes policy verification criteria for accepting private flood insurance policies that fall short of the Biggert-Waters requirements.

GENERAL REQUIREMENTS

Credit unions are generally prohibited by section 760.3 from making, increasing, extending or renewing a "designated loan," unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. A "designated loan" is defined as a loan secured by a building or mobile home (including manufactured homes) that is located or will be located in a SFHA within a community that participates in the NFIP.

Credit unions may also make loans located in a SFHA within a community that does not participate in the NFIP, so long as the loan is consistent with safe and sound risk management principles. One such risk management measure may be to require the borrower to obtain private flood insurance coverage. Government-backed loans (i.e., SBA, VA and FHA loans), however, will not permit the credit union to extend such loans in a community that does not participate in the NFIP, as clarified in the Interagency Questions and Answers Regarding Flood Insurance.

Coverage Amount

The amount of insurance coverage must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the NFIP. The maximum limit of coverage under the NFIP is $250,000 for a residential building and $500,000 for a nonresidential building. Credit unions may make the risk management decision to require more insurance coverage, but such coverage may have to be obtained through private insurers.

Exemptions

The requirement to purchase flood insurance coverage does not apply to certain properties and structures that would otherwise be considered a designated loan, including:

- Any state-owned property covered under a policy of self-insurance satisfactory to the administrator of FEMA (the administrator publishes and periodically revises the list of states falling within this exemption);
- Property securing any loan with an original principal balance of $5,000 or less and a repayment term of one year or less; or
- Any structure that is part of any residential property but is detached from the primary residential structure and does not serve as a residence.

When applying the exemption for certain detached structures, the following factors determine whether a particular structure qualifies for the exemption:

- **Structure that is part of a residential property.** A structure is part of a residential property if it is used for personal, family or household purposes. Structures used for agricultural, commercial, industrial or other business purposes will not be considered "part of a residential property."
- **Detached.** A structure is "detached" if it is not joined by any structural connection to the primary residential structure. For example, a shed on the property that is not connected to the residence would be considered "detached."
- **Serve as a residence.** Whether a structure serves as a residence is based on a good faith determination by the credit union that the structure is intended for and actually used as a residence. A residence generally includes sleeping, bathroom and kitchen facilities.

If the credit union determines that the structure does not qualify for an exemption, it would be prohibited from making a loan secured either in whole or in part by the structure unless the borrower purchased flood insurance.

MORE INFORMATION: NCUA **Regulatory Alert 13-RA-03, provides guidance to federally-insured credit unions on Biggert-Waters. The regulatory alert also includes an Interagency Statement on the impact of Biggert-Waters.**

STANDARD FLOOD HAZARD DETERMINATION FORM

Credit unions must use FEMA's standard flood hazard determination form (SFHDF) for all loans that could be subject to this rule in order to determine if a building or mobile home is located in a SFHA. Section 760.8(b) of NCUA's flood rule permits credit unions to charge a reasonable fee to the borrower for conducting this determination in the following circumstances:

- When the borrower initiates a transaction that triggers a determination;
- When the determination is triggered by a revision or update of FEMA's flood maps;
- When the determination is prompted by FEMA's publication of notices affecting the area in which the property is located; or
- When the determination results in forced-placed insurance.

The determination fee may also include a fee for life-of-loan monitoring.

The SFHDF may be used in a printed, computerized or electronic manner and may be obtained from FEMA. The completed form must be kept on record while the credit union owns the loan. The credit union is not required to provide a copy of this form to the borrower, but may do so, and the borrower may wish to provide it to the insurance agent.

Section 4104b explains that if the credit union increases, extends, renews or purchases a loan, it may rely on a previous determination if that determination is not more than seven years old; the basis for the determination was set forth on the SFHDF and there have not been any map revisions or updates since that determination was made. It may not rely on a previous determination when it makes a new loan. However, if the credit union makes subsequent loans to the same borrower secured by the same building, it may rely on its previous determination if it is not more than seven years old, the basis for the determination was set forth on the SFHDF and there have not been any map revisions or updates since that determination was made. Similarly, if a loan refinancing or assumption is made by the same lender who obtained the original SFHDF on the same property, the lender may rely on the original SFHDF under the same conditions listed previously.

MORE INFORMATION: FEMA's regulations, codified at 44 CFR Parts 65 and 70, set out the mapping determination procedures and provide the requirements for the SFHDF.

NOTICE TO BORROWER

When a credit union makes, increases, extends or renews a loan secured by a building or a mobile home located or to be located in a SFHA, it must provide a written notice of flood hazards to the borrower within a reasonable time before consummation of the loan. This notice is required regardless of whether the building or mobile home securing the loan is located in a community that participates in the NFIP. For loans with multiple borrowers, the credit union need only provide notice to any one of the borrowers. Notice must also be provided to the servicer. The credit union must retain a record of the receipt of the notices by the borrower and servicer as long as the credit union owns the loan. The notice must contain the following information from section 760.9:

1. A warning, in a form approved by the administrator of FEMA, that the property is located in a SFHA;
2. A description of the flood insurance purchase requirements;
3. A statement that flood insurance coverage is available under the NFIP (if applicable), and may also be available from private insurers;

4. A statement that flood insurance that provides the same level of coverage as a standard flood insurance policy under the NFIP may also be available from a private insurance company;
5. A statement that the borrower is encouraged to compare flood insurance coverage, deductibles, exclusions, conditions and premiums associated with flood insurance issued on behalf of the NFIP with coverage offered by private insurance companies; and
6. A statement on whether federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a federally-declared disaster.

When a credit union is also required to escrow premiums and fees for flood insurance, it must deliver a notice informing the borrower that the credit union is required to escrow all premiums and fees required for flood insurance as part of this notice. Appendix A to Part 760 contains a sample form credit unions may use and is a safe harbor to compliance with the notice requirements.

As an alternative to providing the notice to the borrower, a credit union may obtain written assurances from a seller to provide the notice to the purchaser within a reasonable time before the completion of the sale. If relying on this alternative notice, section 760.9(e) requires the credit union to maintain a record of the written assurance for as long as the credit union owns the loan.

RESEARCH TIP: **Regulators have proposed amendments to the Interagency Q&As which may be finalized in 2022. Existing Q&As can be found here. These documents answer many frequently asked questions about how credit unions are expected to comply with the requirements of the NFIP in a variety of situations. It contains helpful guidance that may not be found in other publications or in rules issued by FEMA, NCUA or the federal banking agencies.**

Borrower Relief

If borrowers do not agree with the credit union's SFHD, they have several options, briefly described below. If successful, such borrowers would not be required to purchase flood insurance under federal requirements, but the credit union may still require flood insurance under its own risk-based lending policies. Thus, the credit union may or may not waive flood insurance requirements when a borrower presents the credit union with one of the documents described below.

Letter of Determination Review (LODR)

If the borrower does not agree with the determination that the building is located in a SFHA, section 65.17 of FEMA's regulations states the borrower and the lender may request that FEMA review the lender's determination, for a fee. This request must be submitted no later than 45 days after the credit union notified the borrower of its determination. FEMA will issue a Letter of Determination Review (LODR) in response. This letter is not a map amendment but rather a finding as to the specific building and whether it is in the SFHA shown on the flood map.

Letter of Map Amendment (LOMA)

A Letter of Map Amendment (LOMA) is an official amendment by FEMA to the flood map. Section 70.3 allows a borrower to request a LOMA when the borrower believes the property has inadvertently been placed in a SFHA. This generally occurs when the maps show the property to be in the SFHA but, in reality, the property is above the base flood elevation due to natural rises in the terrain. The purpose of the LOMA is to remove building(s) or lot(s) from the SHFA. FEMA has 60 days to respond to a request. A borrower would not request a LOMA if the property has been elevated by fill.

Letter of Map Revisions Based on Fill (LOMR-F)

An owner of property that is raised above the base flood elevation by the placement of fill may request a Letter of Map Revisions Based on Fill (LOMR-F). Fill is defined as any material placed to raise the ground to or above the base flood elevation (BFE). The BFE is the height of the base flood. The base flood is the flood having a one percent chance of being equaled or exceeded in any given year. Basically, the building or structure has been raised above the natural elevation by the placement of material. Upon receipt of a request for a LOMR-F, FEMA has 90 days to respond.

RESEARCH TIP: FEMA's Change Your Flood Zone Designation webpage provides additional information about LODRs, LOMAs, and LOMR-Fs.

FORCED PLACEMENT OF FLOOD INSURANCE

If the credit union determines that an existing loan is in a SFHA and it is not already covered by flood insurance or is covered in an amount less than required, it must send notice to the borrower that flood insurance must be obtained at the borrower's expense for the remaining term of the loan. If the borrower fails to obtain sufficient flood insurance within 45 days after delivery of the notice, the credit union must purchase it on the borrower's behalf. The credit union may pass on the costs to the borrower, including premiums and fees, of purchasing the flood insurance.

When a credit union (or its servicer if applicable) receives confirmation of a borrower's existing flood insurance coverage, the credit union is required to terminate any force-placed flood insurance coverage within 30 days of receipt. The credit union must also provide a refund of all premiums and fees paid by the borrower during any period where the borrower's coverage and the credit union's force-placed coverage were each in effect. The fees subject to refund include any fees charged to the borrower for the purchase of the force-placed flood insurance.

The credit union is required to accept an insurance policy declarations page that includes the existing flood insurance policy number and the identity of, and contact information for, the insurance company or agent as confirmation of a borrower's existing flood insurance coverage.

ESCROW REQUIREMENT

This rule is fairly straightforward: a credit union must require the escrow of all premiums and fees for flood insurance that is required under section 760.3 in connection with designated loans made, increased, extended or renewed on or after January 1, 2016. For loans made before January 1, 2016, a credit union is required to escrow for flood insurance premiums and fees if it also escrows for taxes, insurance premiums, fees or other charges. But credit unions must offer borrowers the option to escrow premiums and fees for flood insurance for loans made before January 1, 2016, that are not subject to mandatory escrow.

The credit union, or the servicer if the credit union is not servicing the loan, will then pay the flood insurance premiums on behalf of the borrower from the escrow account. These escrow accounts are governed by the general requirements for escrow accounts under Section 10 of RESPA and its implementing regulations issued by the CFPB.

MORE INFORMATION: Requirements for servicing escrow accounts are discussed in further detail in Section 9 of this chapter.

There are six exemptions to the escrow requirement based on the type of loan or whether flood insurance is offered to borrowers under a group policy. Credit unions will not be required to escrow for mandatory flood insurance when:

- The loan is an extension of credit primarily for business, commercial or agricultural purposes;
- The loan is in a subordinate position to a senior lien secured by the same residential improved real estate or mobile home;
- Flood coverage is provided under a group policy;
- The loan is a home equity line of credit;
- The loan is a nonperforming loan (90 days or more past due) and remains nonperforming; or
- The loan has a term of 12 months or less.

Not all group policies, however, will be eligible for the escrow exemption. Generally, eligible group policies must:

- Meet the coverage requirements under the NFIP;
- Be provided by a condominium association, cooperative, homeowners association, or other applicable group; and
- Have premiums paid by that group as a common expense.

If at any time the credit union determines an exception no longer applies, it must require the escrow of flood insurance premiums and fees as soon as reasonably practicable.

In addition, there is an exemption for certain "small creditors." To qualify for this exemption, credit unions must have total assets of less than $1 billion as of December 31 of either of the two prior calendar years. In addition, on or before July 6, 2012, the credit union must not have been required under federal or state law to deposit taxes, insurance premiums, fees or any other charges in an escrow account and must not have had a policy of consistently and uniformly requiring the escrow of taxes, premiums, fees or any other charges. This exemption is not available where credit unions are required to escrow for premiums and fees under state law.

If the credit union previously qualified for the "small creditor" exception but no longer qualifies because it had assets of $1 billion or more for two consecutive calendar year ends, the credit union must escrow premiums and fees for any loan made, increased, extended or renewed on or after July 1 of the first calendar year of the changed status. For loans outstanding on July 1, the credit union must offer and make available the option to escrow premiums and fees for flood insurance.

NOTICE OF SERVICER'S IDENTITY

When a credit union makes, increases, extends, renews, sells or transfers a loan, the credit union must notify the Administrator of FEMA in writing of the identity of the servicer of the loan. The notice may be provided electronically. In addition, when servicing rights are transferred, the credit union must notify the Administrator of FEMA within 60 days after the effective date of the change.

ACCEPTANCE OF PRIVATE FLOOD INSURANCE POLICIES

In an effort to decrease the reliance on federally-subsidized flood insurance, Biggert-Waters requires lenders, including credit unions, to accept private flood insurance as satisfaction of the flood insurance requirements if the policy meets certain standards. Qualifying as "private flood insurance" under Biggert-Waters means that an insurance policy meets all of the following criteria:

- The policy is issued by an insurance company or surplus lines insurer that is approved to engage in the business of insurance by the insurance regulator of that State or jurisdiction in which the property to be insured is located;
- The policy provides flood insurance coverage that is at least as broad as the coverage provided under a standard flood insurance policy under the NFIP, (including consideration for deductibles, exclusions, and conditions offered by the insurer);
- The policy requires the insurer to provide 45 days advanced written notice before cancellation or non-renewal of flood insurance coverage to the insured and the financial institution, or a servicer acting on the institution's behalf;
- The policy includes information about the availability of flood insurance coverage under the NFIP;
- The policy includes a mortgage interest clause similar to the clause contained in a standard flood insurance policy under the NFIP;
- The policy includes a provision requiring the member to file suit within one year after the date of a written denial for all or part of an insurance claim; and
- The policy contains cancellation provisions that are as restrictive as the provisions contained in a standard flood insurance policy.

Compliance Aid Statement

The requirements for a private flood insurance policy may not always be satisfied based on information from an insurance declarations page which is commonly provided to credit unions. In lieu of requiring a credit union to review a full private flood insurance policy to ensure it meets these requirements, section 760.3(c)(2) permits credit unions to conclude that a private flood insurance policy is compliant if the policy or an endorsement to the policy provides a "compliance aid statement," as follows:

> "This policy meets the definition of private flood insurance contained in 42 U.S.C. 4012a(b)(7) and the corresponding regulation."

In other words, if the insurance policy attests to this compliance aid statement, the credit union must accept the policy and is not required to review the plan to determine whether it meets the seven elements of the definition of private flood insurance from Biggert-Waters.

MORE INFORMATION: A credit union participating in secondary market sales may have additional investor requirements that may not be satisfied with this compliance aid statement, in which case, an in-depth review of the private flood insurance policy may be required. See the Fannie Mae *Selling Guide* Announcement SEL-2018-09 and the Freddie Mac Single Family Seller/Servicer Guide for more.

Discretionary Acceptance of Private Insurance

While the acceptance of private flood insurance meeting the Biggert-Waters requirements is mandatory, section 760.3(c)(3) provides a discretionary acceptance provision which permits credit unions to make the risk-based decision to accept private flood insurance policies that do not meet the Biggert-Waters definition, but otherwise meet the following minimum requirements:

- The policy must provide coverage in the amount required by the flood insurance purchase requirement;
- The policy must be issued by an insurer that is licensed, admitted, or otherwise approved to engage in the business of insurance by the insurance regulator of the State or jurisdiction in which the property to be insured is located;
- The policy must cover both the mortgagor(s) and the mortgagee(s) as loss payees, except in the case of a policy that is provided by a condominium association, cooperative, homeowners association or other applicable group and for which the premium is paid by the condominium

association, cooperative, homeowners association or other applicable group as a common expense; and

- The policy must provide sufficient protection of the designated loan, consistent with general safety and soundness principles, and the regulated lending institution must document its conclusion regarding sufficiency of the protection of the loan in writing.

NAFCU NOTE

The mandatory acceptance of private flood insurance policies became mandatory on July 1, 2019 and is covered in further detail in this NAFCU *Compliance Blog* post.

Mutual Aid Societies

NCUA provides credit unions the additional flexibility to accept a plan issued by a "mutual aid society" as defined in section 760.2. To accept a mutual aid flood insurance policy, the policy is required to qualify as flood insurance under NCUA's determination and meet some of the criteria for discretionary acceptance of a flood insurance policy.

RESEARCH TIP: NCUA covered these and other alternatives to the NFIP in Regulatory Alert 19-RA-01. NCUA also has a flood insurance resources page which provides additional pertinent information.

CHAPTER 4

BSA, Privacy and Security

CHAPTER 4 — BSA, PRIVACY AND SECURITY

SECTION 1 — THE BANK SECRECY ACT AND OFAC

OVERVIEW

While credit union compliance officers are often generalists, many of them have been forced to expend a good deal of scarce resources toward complying with Bank Secrecy Act (BSA) and Office of Foreign Assets Control (OFAC) requirements. Since 2001, federal regulators have increased expectations regarding BSA and OFAC. With those increased expectations, credit unions and other financial institutions have had to beef up internal controls and expend additional resources.

This section is designed to provide a general overview of basic BSA and OFAC requirements. This section is not designed to be a comprehensive overview of all requirements in this area.

THE BANK SECRECY ACT

The BSA, its implementing regulations and guidance documents form a mixture of strict requirements and risk-based internal controls designed to combat money laundering, terrorist financing and other financial crimes. In this section, when referring to "BSA," it generally includes the Bank Secrecy Act, its implementing regulations, and all applicable guidance documents (such as the Federal Financial Institutions Examination Council's (FFIEC) Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual).

An Overview of the Bank Secrecy Act System

From a distance, the BSA system is fairly simple. Depository institutions, as well as certain other U.S. businesses, must build BSA/AML programs designed to meet federal requirements and deter money laundering, terrorist financing and other financial crimes from occurring through the institution. The BSA system is intended to deter crime, identify potential criminal actors and generate records and documents that will assist in the prosecution of individuals who engage in illicit financial activities.

Treasury Regulations and FinCEN

The Department of the Treasury (Treasury) oversees the BSA and has issued numerous implementing regulations. Located at 31 CFR Chapter X, the regulations address every aspect of BSA compliance, including Currency Transaction Reports (CTRs), Suspicious Activity Reports (SARs), Customer Identification Programs (CIP) and recordkeeping. When researching a BSA-related compliance issue, keep in mind that Treasury regulations form the backbone of BSA regulatory requirements.

Treasury established the Financial Crimes Enforcement Network (FinCEN) in 1990 to provide a government-wide multisource financial intelligence and analysis network. FinCEN is the government body charged with the implementation of the BSA on behalf of Treasury, and with issuing regulations and guidance deemed necessary to implement the BSA.

While the Treasury regulations form the backbone of the BSA compliance system, the National Credit Union Administration (NCUA) has its own set of BSA regulations located in Part 748. These regulations mandate certain core requirements as well as a general requirement to comply with the Treasury regulations. NCUA's requirements are discussed within the relevant topics.

RESEARCH TIP: NCUA's Bank Secrecy Act Resources and the NCUA section on the FFIEC's agency resources webpage include all of NCUA's BSA-related information and guidance.

The USA PATRIOT Act

The USA PATRIOT Act of 2001 (PATRIOT Act), enacted shortly after the 9/11 attacks, broadened the scope of the BSA to focus on terrorist financing as well as money laundering. It gave FinCEN additional responsibilities and authorities in both important areas and established the organization as a bureau within Treasury. The PATRIOT Act is not synonymous with the BSA. Rather, it is simply one of the latest laws impacting the scope and reach of the BSA.

The FFIEC BSA/AML Examination Manual

In 2005, the financial institution regulators that comprise the FFIEC, including NCUA, published the FFIEC BSA/AML Examination Manual (FFIEC manual) to provide guidance to examiners who were completing BSA and OFAC related examinations. Regulators understood that an effective BSA/AML compliance program requires sound risk management, so the manual provides guidance on identifying and controlling risks associated with money laundering and terrorist financing and a comprehensive listing of examiner expectations. It contains an overview of BSA/AML compliance program requirements; BSA/AML risks and risk management expectations; industry sound practices and examination procedures. As a result, it can be a useful tool when conducting BSA or OFAC related research. The manual is updated as needed to include new risk management requirements and to incorporate recently issued guidance.

RESEARCH TIP: FinCEN's website is another primary tool for researching BSA regulations and guidance. Useful pages on this website include financial institutions, legal authorities and filing information. FinCEN also issues guidance and advisories regarding its regulations.

BSA COMPLIANCE PROGRAM

Both section 1020.210 of Treasury's regulations and section 748.2 of NCUA's regulations require credit unions to have a written BSA compliance program. The compliance program must include the following requirements:

1. A system of internal controls to ensure compliance;
2. A system of independent testing;
3. An individual designated with the responsibility for day-to-day compliance;
4. Training for appropriate personnel; and
5. Risk-based procedures for ongoing customer due diligence.

These are the "five pillars" of BSA/AML compliance. The fifth pillar, customer due diligence (CDD), was added by a 2016 final rule. NCUA has not added the fifth pillar to its regulation and instead incorporates the rule's requirements into the internal controls pillar and the customer identification program requirements. As a result, section 748.2 only includes four pillars. This section mirrors FinCEN and industry, which generally refer to a compliance program as having five pillars.

Internal Controls

A credit union's board of directors is responsible for implementing policies and procedures designed to ensure compliance with all BSA requirements. These policies and procedures should be tailored to the credit union's size, risk profile and complexity of operations. The FFIEC manual provides a list of items that should be addressed by a credit union's internal controls, including: identifying the person responsible for BSA compliance; implementing risk based CDD policies, procedures and processes; providing sufficient systems for filing SARs and CTRs and requiring the board and senior management be informed of any compliance deficiencies.

This list, as well as the more comprehensive one in the manual, is not exhaustive. Other items may need to be included in internal controls based on the credit union's risk assessment (discussed later in this section).

Independent Testing

Independent testing is conducted to evaluate the compliance program, assess a credit union's BSA compliance and test systems. The FFIEC manual explains testing should be conducted by an internal audit department or outside auditors or consultants. When conducted by an internal audit department, the testing should not be done by any person involved in the function being tested. The scope and frequency of testing should be based on the credit union's risk profile; testing should be conducted every 12 to 18 months.

> **EXAMPLE**
>
> If a member of the audit team is responsible for any of the BSA/AML functions being tested, including training or developing policies and procedures, that involvement may present a conflict or lack of independence.

Compliance Officer

A credit union's board designates the BSA compliance officer. The FFIEC manual explains the BSA compliance officer is responsible for overseeing the day-to-day implementation of the compliance program and managing compliance with all regulations and internal procedures. This person must have extensive knowledge of the BSA and its implementing regulations, as well as authority and resources to administer an effective BSA/AML compliance program. The regulatory requirement is not met by merely appointing a BSA compliance officer if that person does not have the expertise, authority, or time to satisfactorily complete the job.

Training

Training must be provided to appropriate personnel. The training should be tailored to the employee's responsibilities, be ongoing and cover regulatory requirements and developments, as well as the credit union's internal policies and procedures. Credit unions should ensure all employees understand their role in maintaining an effective BSA/AML compliance program. A credit union's board of directors must also receive BSA training. Although the board of directors may not require the same level of training as other personnel, the FFIEC manual explains the board must have a general understanding of the importance of BSA/AML regulatory requirements, the penalties for noncompliance and the credit union's BSA risk. Additionally, supervisory committee members should receive enough BSA/AML training to enable them to provide adequate oversight.

Customer Due Diligence

Customer Due Diligence (CDD) requires credit unions to implement and maintain risk-based procedures for conducting identification and verification at account opening and performing ongoing monitoring. The CDD requirements are discussed in detail below.

RESEARCH TIP: The FFIEC BSA/AML InfoBase is not only where to find the FFIEC BSA/AML Examination Manual but also additional FFIEC resources.

BSA RISK ASSESSMENT

A major component of any compliance program is the risk assessment, which identifies BSA/AML risks unique to the individual credit union. The risk assessment should provide a comprehensive analysis of the BSA/AML risks in a concise and organized presentation and should be shared and communicated with all business lines across the credit union, the board of directors, management and appropriate staff. With that in mind, NCUA considers it a sound practice to have a written risk assessment.

The FFIEC manual explains the development of the risk assessment generally involves two steps. First, the specific risk categories unique to the credit union are identified. These include the credit union's specific products and services, its members, and geographic locations. Second, the data identified in step 1 is analyzed further to better assign risk within the categories. For example, Step 1 could identify a product that carries additional BSA related risks, such as international wires. Step 2 would then examine how many international wires the credit union typically does in a year to provide a more accurate measurement of the credit union's BSA risk.

Management should structure the credit union's BSA/AML compliance program to adequately address its risk profile, as identified by the risk assessment. Management should understand the credit union's BSA/AML risk exposure and develop the appropriate policies, procedures and processes to monitor and control BSA/AML risks.

EXAMPLE

The credit union's monitoring systems to identify research and report suspicious activity should be risk-based, with particular emphasis on higher-risk products, services, members and geographic locations as identified by the credit union's BSA/AML risk assessment.

NCUA's AIRES Questionnaire, which was retired in 2022 and replaced with MERIT, indicated an effective risk assessment should be an ongoing process, not a one-time exercise. Management should update its risk assessment to identify changes in the credit union's risk profile, as necessary (e.g., when new products and services are introduced). Even in the absence of such changes, it is a sound practice for a credit union to periodically reassess its BSA/AML risks at least every 12 to 18 months.

CUSTOMER DUE DILIGENCE

In 2016, FinCEN adopted a rule, which incorporated existing CDD supervisory expectations into the BSA regulations. Section 1020.210(a)(2)(v) requires credit unions to maintain risk-based procedures for conducting ongoing due diligence. The preamble to the rule identified four key components for due diligence:

1. Identifying and verifying customers' identities;
2. Identifying and verifying beneficial owners of legal entity customers;
3. Understanding the nature and purpose of customer relationships; and
4. Ongoing monitoring to report suspicious transactions and updating customer information on a risk basis.

The following sections explain the requirements of the CDD components.

Customer Identification Program

The PATRIOT Act and federal regulations require each credit union to implement a written CIP that includes certain minimum requirements, such as the collection of identifying information at account opening and risk-based identity verification procedures. The purpose of the CIP is to allow the credit union to form a reasonable belief that it knows the true identity of each customer.

The CIP rules are found in section 748.2(b)(2) of the NCUA regulations and section 1020.220 of the FinCEN regulations. Under the rules, a "customer" generally means a person that opens a new account and a person who opens an account for an individual who lacks legal capacity or an entity that is not a legal person (such as a civic club). An "account" generally means a formal banking relationship such as a deposit account, a transaction or asset account, a credit account or other extension of credit. It also includes a relationship established to provide a safety deposit box or other safekeeping services, or cash management, custodian and trust services.

The credit union's CIP must contain account opening procedures that detail what identifying information will be obtained from each customer. Section 1020.220(a)(2) requires a credit union to obtain, at a minimum, the following information from the customer:

- Name;
- Date of birth, for an individual;
- Address (residential for an individual, business address for an entity); and
- Identification number (social security number for an individual, taxpayer identification number for an entity).

In addition, depending on the risk assessment, the credit union may require additional identifying information for certain customers or products.

NAFCU NOTE

For an explanation of when a credit union may copy a state-issued identification as part of online account opening, check out this NAFCU *Compliance Blog* post.

The credit union's CIP must also contain risk-based procedures for verifying the identity of the customer using the information it has collected, including describing when documentary procedures, nondocumentary procedures or a combination of both will be used. If the credit union uses documentary verification, the FFIEC manual explains these documents may include an unexpired government-issued identification for individuals or documents showing the existence of an entity for businesses, such as certified articles of incorporation or a government-issued business license. If the credit union chooses to use nondocumentary verification, CIP procedures must describe the acceptable process used. The Manual provides a discussion of possible verification procedures, as well as specific situations the nondocumentary portion of the CIP must address.

The CIP must also address situations requiring additional verification and procedures for responding to circumstances in which the credit union cannot form a reasonable belief that it knows the true identity of the customer.

Identification and Verification of Beneficial Owners

Section 1010.230 requires a credit union to identify and verify the identity of any natural person that is the beneficial owner of a legal entity each time a new account is opened. Legal entity refers to a corporation, limited liability company or other entity created by the filing of a public document with a Secretary of State or a similar office. It does not include sole proprietorships, unincorporated associations, federal or state regulated financial institutions, trusts, investment companies, public accounting firms registered under the Sarbanes-Oxley Act and bank holding companies.

MORE INFORMATION: FinCEN has issued numerous FAQs on the CDD rule to further assist credit unions in understanding the rule. The first set of FAQs can be found in FIN-2016-G003 and the second set can be found in FIN-2018-G001. The FFIEC BSA/AML Examination Manual also provides an explanation of the rule's requirements.

A beneficial owner is a natural person whose interests in the legal entity take the form of "ownership" or "control." The ownership prong covers any person who directly or indirectly owns at least 25 percent of the equity interests of a legal entity customer. The control prong covers an individual with significant responsibility to control, manage or direct a legal entity customer, such as an executive officer or senior manager. An individual can have both an ownership interest and a control interest in the same legal entity.

Credit unions are required to obtain the same information described under CIP requirements (name, date of birth, address and identification number) for the zero to four beneficial owners that meet the 25 percent ownership threshold and one person with management responsibility of the legal entity. The credit union is also required to obtain the title of the management individual.

Appendix A to section 1010.230 provides a sample certification form that can be used by the credit union to gather this information. The use of the certification form is not mandatory so the credit union may also obtain this information in a substantially similar manner.

EXAMPLE

Mr. and Mrs. Smith each hold a 50 percent equity interest in "Mom & Pop, LLC." Mrs. Smith is the company's President and Mr. Smith is its Vice President. Mom & Pop, LLC is required to provide the personal information of both Mr. & Mrs. Smith under the ownership prong. Under the control prong, Mom & Pop, LLC is also required to provide the personal information of one individual with significant responsibility to control Mom & Pop, LLC; this individual could be either Mr. or Mrs. Smith, or a third person who otherwise satisfies the definition. Mom & Pop, LLC would be required to identify at least two, but up to three distinct individuals. The preamble to the CDD rule provides additional examples of how to identify the beneficial owner(s) of legal entities

The information obtained must be verified within a "reasonable time" after the account is opened using the same elements required for verifying the identity of individuals under CIP. A record of the description of the identification methods and documents should also be kept along with any measures taken and resolution of any major discrepancy issues. Unlike with CIP for individual accounts, the credit union may rely on photocopies or other reproductions of identification documents in the case of documentary verification. In addition, a credit union can rely on another financial institution's CIP with respect to a legal entity customer that is opening an account under certain conditions, as described in the FFIEC manual.

NAFCU NOTE

FinCEN is currently working to promulgate rules under the Corporate Transparency Act (CTA), which will remove the requirement for credit unions to collect beneficial ownership information. Instead, corporations, LLCs and other legal entities will be required to submit their beneficial ownership information directly to FinCEN, and credit unions will be able to retrieve that information from FinCEN's database. Thus, the landscape around beneficial ownership requirements could change significantly in the near future. For updates on the CTA rulemakings, subscribe to NAFCU's *Compliance Blog*.

Nature and Purpose of Customer Relationship

The concept that financial institutions should understand the nature and purpose of the customer relationship is not new and is generally known as "Know Your Customer" (KYC). NCUA, as part of the FFIEC, has expectations that credit unions will conduct CIP and also identify relationships that pose a higher degree of money laundering and terrorist financing risk as part of an effective BSA/AML program.

KYC requires financial institutions to understand the nature and purpose of customer relationships for the purpose of developing a customer risk profile. A customer risk profile is composed of information obtained at account opening such as the type of customer (i.e., individual or business) or type of account, service or product. The purpose of the profile is to create a baseline of expected activity for that specific member, account, service or product, and compare it against actual account activity to better identify suspicious activity. The customer profile may include a system of risk ratings or categories of customers.

EXAMPLE

A savings account generally has a lower risk than a transaction account with international wire transfer capabilities. Similarly, an account for a U.S. person may present lower risks than an account for a Money Service Business that serves international clients. The FFIEC Manual and Appendix K provides examples of how credit unions can risk rate customers, accounts and services.

FinCEN and other federal regulators have stated that "[n]ot all customers of a particular type automatically represent a uniformly higher risk of money laundering, terrorist financing, or other illicit financial activity." Instead, the agencies encourage credit unions to assess the risk posed by *each* specific customer, based on the particular facts and circumstances.

Ongoing Customer Due Diligence

Credit unions are expected to maintain and update customer information (including beneficial ownership information) on a risk basis – meaning there is no requirement to regularly update the account information on an existing account unless there is a triggering event. Information should be updated when, in the normal course of business, the credit union detects a relevant change to the account that leads it to believe there might be a change to the nature and purpose of the customer relationship. The CDD rule does not have a prescriptive list of events that will trigger a review of an account. Rather the rule follows the same risk-based review format of other BSA requirements. These risk-based provisions allow a credit union the flexibility to determine its own triggering events and implement appropriate review procedures. Triggering events many include, among other things, a notable increase in CTR filings or changes regarding beneficial owners of an entity. If the credit union detects a triggering event, it is important that the customer risk profiles be adjusted or suspicious activity reported when the activity is inconsistent with the profile.

REQUIRED REPORTS

Currency Transaction Reports

A credit union must file a currency transaction report (CTR) for each transaction in currency (deposit, withdrawal, exchange, or other payment or transfer) of more than $10,000 by, through or to the credit union. Currency is defined in the FFIEC manual as coin and paper money of the United States or any other country as long as it is customarily accepted as money in the country of issue.

Multiple currency transactions totaling more than $10,000 during any one business day are treated as a single transaction if the credit union has knowledge that it is by or on behalf of the same person. Transactions throughout the credit union should be aggregated when determining whether the single day CTR reporting threshold has been met. The FinCEN CTR FAQs note that a credit union should look at whether a particular type of transaction (i.e. deposits, withdrawals, etc.) has crossed the $10,000 threshold, but should *not* offset deposits and withdrawals against each other.

EXAMPLE

Member A comes into the credit union and deposits $12,000 in cash. Later that day he also withdraws $4,000 in cash. According to the FinCEN FAQs, a credit union should not subtract the withdrawals from the deposits. Instead, the $12,000 in deposits would trigger the requirement to file a CTR because it crosses the $10,000 threshold.

Types of currency transactions subject to reporting requirements, individually or by aggregation, include, but are not limited to, denomination exchanges, individual retirement account (IRA) disbursements, loan payments, automated teller machine (ATM) transactions, purchases of certificates of deposit, deposits and withdrawals, funds transfers paid for in currency and monetary instrument purchases.

NAFCU NOTE

For details on how to handle more complex CTR issues, such as aggregating multiple transactions, joint accounts and business accounts, see this NAFCU *Compliance Monitor* article (member only). This NAFCU *Compliance Blog* post also discusses aggregating nonmember transactions.

A completed CTR must be filed with FinCEN within 15 days after the date of the transaction. The credit union must retain copies of CTR filings for five years from the date of the report.

MORE INFORMATION: If a financial institution fails to file CTRs on reportable transactions, it should begin filing CTRs from that point forward and should contact the FinCEN's Regulatory Helpline to request a determination on whether the backfiling of unreported transactions is necessary.

CTR Exemptions

Regulators acknowledge that reporting certain types of large currency transactions does not necessarily aid law enforcement authorities and may place unreasonable burdens on banks and credit unions. Consequently, a credit union may exempt certain types of members from currency transaction reporting.

Current regulations contain a two-phase exemption process. Under Phase I exemptions, transactions in currency by banks (including credit unions), governmental departments or agencies and listed public companies and their subsidiaries are exempt from reporting. Phase II provides an exemption for smaller businesses that don't qualify for an exemption under Phase I, and which meet specific requirements in FinCEN's regulations. However, businesses that engage in certain activities are ineligible for a CTR exemption. The FFIEC manual provides further discussion of both the Phase I and Phase II exemption requirements and a list of ineligible business activities.

NAFCU NOTE

This post in NAFCU's *Compliance Blog* provides further discussion of CTR exemptions.

Suspicious Activity Reports

The filing of suspicious activity reports (SARs) is the cornerstone of the BSA reporting system. Law enforcement has indicated that SARs are critical to the United States' ability to utilize financial information to combat terrorism, terrorist financing, money laundering and other financial crimes. Regulators stress that the quality of SAR content is critical to the adequacy and effectiveness of the suspicious activity reporting system.

Within this system, FinCEN and NCUA recognize that it is not possible for a credit union to detect and report all potentially illicit transactions that flow through the credit union. A credit union should focus on evaluating its policies, procedures and processes to identify, evaluate and report suspicious activity.

The SAR filing requirements for credit unions are located in section 748.1(c) of the NCUA regulations. The FFIEC manual explains credit unions are required to file a SAR with respect to:

- Criminal violations involving insider abuse in any amount;
- Criminal violations aggregating $5,000 or more when a suspect can be identified;
- Criminal violations aggregating $25,000 or more regardless of whether or not the credit union can identify the suspect; or
- Transactions conducted or attempted by, at or through the credit union (or an affiliate) and aggregating $5,000 or more, if the credit union or affiliate knows, suspects or has reason to suspect that the transaction:
  - May involve potential money laundering or other illegal activity (e.g., terrorism financing).
  - Is designed to evade the BSA or its implementing regulations.
  - Has no business or apparent lawful purpose or is not the type of transaction that the particular member would normally be expected to engage in, and the credit union knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

For suspicious transactions that do not fall within the thresholds listed above, a credit union is not required to file a SAR but may voluntarily choose to do so.

Safe Harbor. Federal law provides protection from civil liability for all reports of suspicious transactions made to appropriate authorities, including supporting documentation, regardless of whether such reports are filed pursuant to the SAR instructions. The safe harbor applies to SARs filed within the required reporting thresholds as well as to SARs filed voluntarily on any activity below the threshold.

Systems to Identify, Research and Report Suspicious Activity. Suspicious activity monitoring and reporting are critical internal controls. Proper monitoring and reporting processes are essential to ensuring that the credit union has an adequate and effective BSA compliance program. Appropriate policies, procedures and processes should be in place to monitor and identify unusual activity. The sophistication of monitoring systems should be dictated by the credit union's risk profile, with particular emphasis on the composition of higher-risk products, services, customers, entities and geographies. The credit union should ensure adequate staff is assigned to the identification, research and reporting of suspicious activities, taking into account the credit union's overall risk profile and the volume of transactions. Monitoring systems typically include employee identification or referrals, transaction-based (manual) systems, surveillance (automated) systems or any combination of these.

MORE INFORMATION: In January 2021, FinCEN, NCUA and other regulators issued interagency guidance on "Frequently Asked Questions Regarding Suspicious Activity Reporting and Other Money Laundering Considerations." The FAQ document discusses a number of operational considerations regarding potentially suspicious activity and whether a SAR should be filed. Additionally, FinCEN's SAR Activity Reviews are a good resource for SAR-related topics.

Identification of Unusual Activity. Credit unions use a number of methods to identify potentially suspicious activity, including but not limited to activity identified by employees during day-to-day operations, law enforcement inquiries such as 314(a) requests, 314(b) information sharing, transaction and surveillance monitoring systems or any combination of these.

Managing Alerts. Alert management focuses on processes used to investigate and evaluate identified unusual activity. The credit union should be aware of all methods of identification and should ensure that its suspicious activity monitoring program includes processes to evaluate any unusual activity identified, regardless of the method of identification. A credit union should have policies, procedures and processes in place for referring unusual activity from all areas of the credit union or business lines to the personnel or department responsible for evaluating unusual activity. Within those procedures, management should establish a clear and defined escalation process from the point of initial detection to disposition of the investigation.

The credit union should assign adequate staff to the identification, evaluation and reporting of potentially suspicious activities, taking into account the credit union's overall risk profile and the volume of transactions. In addition, a credit union should ensure that the assigned staff possess the requisite experience levels and are provided with comprehensive and ongoing training to maintain their expertise. Staff should also be provided with sufficient internal and external tools to allow them to properly research activities and formulate conclusions.

Identifying Underlying Crime. Credit unions are required to report suspicious activity that may involve money laundering, BSA violations, terrorist financing and certain other crimes above prescribed dollar thresholds. However, credit unions are not obligated to investigate or confirm the underlying crime (e.g., terrorist financing, money laundering, tax evasion, identity theft and various types of fraud).

SAR Decision Making. After the research and analysis has been completed, findings are typically forwarded to a final decision maker (individual or committee). The decision to file a SAR is a subjective process. NCUA has indicated that its examiners should focus on whether the credit union has an effective SAR decision-making process, rather than second-guessing individual SAR decisions. When a credit union has an established SAR decision-making process, has followed existing policies, procedures and processes, and has determined not to file a SAR, the credit union should not be criticized for the failure to file a SAR unless the failure is significant or accompanied by evidence of bad faith.

SAR Filing on Continuing Activity. FinCEN guidance indicates that credit unions should report continuing suspicious activity by filing subsequent SAR reports at least every 120 days after the date of the previously related SAR filing, allowing for 90 days of review and 30 days to file. Financial institutions may also file SARs on continuing activity earlier than the 120-day deadline if the institution believes the activity warrants earlier review by law enforcement. This practice is designed to notify law enforcement of the continuing nature of the suspicious activity.

NAFCU NOTE

This NAFCU *Compliance Blog* post provides more details on continuing activity reports.

Timing of a SAR Filing. The SAR rules require that a SAR be filed no later than 30 calendar days from the date of the initial detection of facts that may constitute a basis for filing a SAR. If no suspect can be identified, the time period for filing a SAR is extended to 60 days. Credit unions may need to review transactions or account activity for a member to determine whether to file a SAR. The need for a review of member activity or transactions does not necessarily indicate a need to file a SAR. The time period for filing a SAR starts when the credit union, during its review or because of other factors, knows or has reason to suspect that the activity or transactions under review meet one or more of the definitions of suspicious activity.

Notifying Board of Directors of SAR Filings. Section 748.1(c)(4) of NCUA's regulations requires a credit union to notify the board of directors or an appropriate board committee that SARs have been filed. However, the regulations do not mandate a particular notification format and a credit union has flexibility in structuring its format. Therefore, credit unions may, but are not required to, provide actual copies of SARs to the board of directors or a board committee. Alternatively, credit unions may opt to provide summaries, tables of SARs filed for specific violation types, or other forms of notification. Regardless of the notification format used by the credit union, management should provide sufficient information on its SAR filings to the board of directors or an appropriate committee in order to fulfill its fiduciary duties.

SAR Record Retention and Supporting Documentation. Credit unions must retain copies of SAR filings and supporting documentation for five years from the date of filing the SAR. In addition, credit unions must provide all documentation supporting the filing of a SAR upon request by FinCEN or an appropriate law enforcement or federal banking agency. "Supporting documentation" refers to all documents or records that assisted a credit union in making the determination that certain activity required a SAR filing. No legal process is required for disclosure of supporting documentation to FinCEN, an appropriate law enforcement agency or NCUA.

Prohibition of SAR Disclosure. No credit union, director, officer, employee or agent of a credit union that reports a SAR may notify any person involved in the transaction that a SAR has been filed on that transaction. Therefore, any person subpoenaed or otherwise requested to disclose a SAR, or the information contained in a SAR, must decline to produce the SAR or to provide any information that would disclose that a SAR has been prepared or filed, except when such disclosure is requested by FinCEN, an appropriate law enforcement agency or NCUA. When that happens, FinCEN and NCUA should be notified of any such request and of the credit union's response.

NAFCU NOTE

For more on when a SAR can be shared, take a look at this NAFCU *Compliance Blog* post.

BSA E-Filing

Credit unions are required to file CTRs and SARs electronically through FinCEN's E-Filing System. Mandatory e-filing for CTRs and SARs was implemented as part of FinCEN's information technology modernization efforts to enhance the quality of FinCEN data and improve law enforcement's ability to access and analyze the data. The BSA E-Filing System allows for electronic filing of BSA forms, receiving acknowledgements and tracking the submission status of filings. Users can also receive alerts from FinCEN and have the ability to send and receive secure messages. Appendix T of the FFIEC manual provides additional information on the e-filing process.

RESEARCH TIP: CTR instructions and SAR instructions are useful resources to assist in completing and filing the forms; as are the CTR FAQs and SAR FAQs.

RECORDKEEPING

Monetary Instruments

Credit unions sell a variety of monetary instruments (e.g., official checks or drafts, including foreign drafts, money orders, cashier's checks and traveler's checks) in exchange for currency. A credit union can even sell them to nonmembers who are within its field of membership. Under section 1010.415 of the FinCEN regulations, credit unions are required to verify the identity of persons using "currency" (i.e. cash) to purchase monetary instruments in amounts between $3,000 and $10,000, and to maintain records of all such sales. Multiple purchases during one business day totaling $3,000 or more must be aggregated and treated as one purchase if the credit union has knowledge that the purchases have occurred.

Credit unions may either verify that the purchaser of monetary instruments is an accountholder with identifying information on record with the credit union, or a credit union may verify the identity of the purchaser by viewing a form of identification that contains the member's name and address, and that the financial community accepts as a means of identification. Credit unions must obtain additional information for purchasers who are not members but are within the credit union's field of membership. The method used to verify the identity of the purchaser must be recorded. Many credit unions choose to retain this information in a Monetary Instrument Log (MIL), but the use of a MIL is not required. See section 1010.415 of the FinCEN regulations for a list of the minimum information that must be contained in a credit union's records of monetary instrument sales.

If the purchaser cannot provide the required information at the time of the transaction or through the credit union's previously verified records, the transaction should be refused. The records of monetary instrument sales must be retained for five years and be available to the appropriate agencies upon request.

Funds Transfers

Funds transfer systems enable the instantaneous transfer of funds, including both domestic and cross-border transfers. Consequently, these systems can present an attractive method to disguise the source of funds derived from illegal activity.

For that reason, the BSA system contains recordkeeping requirements to address funds transfers. The rules require each credit union involved in funds transfers to collect and retain certain information in connection with funds transfers of $3,000 or more. The information required to be collected and retained depends on the credit union's role in the particular funds transfer (originator's "bank," intermediary "bank" or beneficiary's "bank"). The requirements may also vary depending on whether an originator or beneficiary is an established member of the credit union and whether a payment order is made in person or otherwise. For an overview of these and other requirements, review the funds transfers section of the FFIEC manual.

The funds transfer rules also mandate that credit unions send certain information with transmittal orders, commonly referred to as the Travel Rule. For funds transmittals of $3,000 or more, the intermediary financial institution must include certain information if received from the sender in a transmittal order at the time that order is sent to a receiving financial institution. This information includes the amount of the transmittal order, information about the transmitter (such as name and account number), the recipient's financial institution and information about the recipient (if provided).

A credit union acting as an intermediary financial institution must pass on all of the information received from a transmittor's financial institution or the preceding financial institution, but it has no duty to obtain information not provided by the transmittor's financial institution or the preceding financial institution.

RESEARCH TIP: **While BSA-related recordkeeping requirements are spread throughout Treasury's BSA regulations, a good summary of the recordkeeping requirements can be found in Appendix P of the FFIEC Manual.**

Record Retention

The BSA establishes record retention requirements related to various types of records including member accounts (e.g., loan, share accounts), BSA filing requirements and records that document a credit union's compliance with the BSA. In general, the BSA requires that a credit union maintain most records for at least five years. These records can be maintained in many forms including original, microfilm, electronic, copy or a reproduction. A credit union is not required to keep a separate system of records for each of the BSA requirements; however, a credit union must maintain all records in a way that makes them accessible in a reasonable period of time.

INFORMATION SHARING

314(a) Information Sharing

Named for the section of the PATRIOT Act that created the information sharing system, a federal, state, local or foreign law enforcement agency investigating terrorist activity or money laundering may make a "314(a) request." Through a 314(a) request, FinCEN solicits, on behalf of the law enforcement agency, certain information from financial institutions, including credit unions. The law enforcement agency must provide a written certification to FinCEN attesting that there is credible evidence of engagement or reasonably suspected engagement in terrorist activity or money laundering for each individual, entity or organization about which the law enforcement agency is seeking information.

Upon receiving an information request, a credit union must conduct a one-time search of its records to determine whether it maintains or has maintained accounts for, or has engaged in transactions with, any specified individual, entity or organization. Unless otherwise instructed by an information request, a credit union must search its records for current accounts, accounts maintained during the preceding 12 months, and transactions conducted outside of an account by or on behalf of a named suspect during the preceding six months. The financial institution must search its records and report any positive matches to FinCEN within 14 days, unless otherwise specified in the information request.

NAFCU NOTE

This NAFCU *Compliance Blog* post provides more on 314(a) sharing.

314(b) Information Sharing

Section 314(b) of the PATRIOT Act encourages financial institutions and associations of financial institutions located in the United States to share information in order to identify and report activities that may involve terrorist activity or money laundering. Section 314(b) also provides specific protection from civil liability. To take advantage of this statutory safe harbor from liability, a financial institution must notify FinCEN of its intent to engage in information sharing and that it has established and will maintain adequate procedures to protect the security and confidentiality of the information. Failure to comply with the requirements will result in loss of safe harbor protection for information sharing and may result in a violation of privacy laws or other laws and regulations.

If a financial institution chooses to voluntarily participate in 314(b) information sharing, policies, procedures and processes should be developed and implemented for sharing and receiving of information.

A notice to share information is effective for one year. A credit union should designate a point of contact and establish a process for sending and responding to information sharing requests. Additionally, a credit union must take reasonable steps to verify that the other financial institution or association of financial institutions with which it intends to share information has also submitted the required notice to FinCEN. FinCEN provides participating financial institutions with access to a list of other participating financial institutions and the related contact information.

NAFCU NOTE

This NAFCU *Compliance Blog* post provides more information on 314(b) sharing.

FinCEN Exchange

FinCEN launched this platform to enhance public-private information sharing. According to FinCEN, "[t]he objective of FinCEN Exchange is to develop, deliver, and sustain innovative public-private information sharing in order to enable the private sector to better identify risks and provide FinCEN and law enforcement with critical information to disrupt money laundering, terrorism financing, and other financial crimes."

Participation in the FinCEN Exchange is strictly voluntary with no new regulatory requirements, but institutions must be invited by FinCEN to participate. FinCEN will invite financial institutions to participate based on a variety of factors, including whether an institution may have information that is relevant to a particular topic. This new platform does not replace or affect any existing channels by which law enforcement interacts directly with the financial industry. FinCEN indicates regular and as-needed operational briefings under this new program will be issued.

ENFORCEMENT

Pursuant to federal laws, the federal banking agencies (including NCUA) and FinCEN can bring civil money penalty actions for violations of the BSA. Also, in addition to criminal and civil money penalty actions taken against financial institutions, individuals, including employees and officials, may be removed from banks and credit unions for a violation of the anti-money laundering requirements if the violation was purposeful or intentional.

Keep in mind that NCUA has indicated that it desires to handle perceived compliance issues informally at first. If problems persist, NCUA will ratchet up its enforcement action as necessary. NCUA has the ability to issue a finding, a Document of Resolution, Letter of Understanding and Agreement and Cease and Desist Order, among other possible enforcement actions.

OFAC

Overview

The Office of Foreign Assets Control (OFAC) is an office of the U.S. Treasury that administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against entities such as targeted foreign countries, terrorists, international narcotics traffickers and those engaged in activities related to the proliferation of weapons of mass destruction.

OFAC acts under Presidential wartime and national emergency powers, as well as authority granted by specific legislation, to impose sanctions, controls on transactions and to freeze assets under U.S. jurisdiction. OFAC has been delegated responsibility by the Secretary of the Treasury for developing, promulgating and administering U.S. sanctions programs.

All U.S. persons, including U.S. credit unions, must comply with OFAC's regulations. NCUA evaluates OFAC compliance systems to ensure that all credit unions subject to its supervision comply with the sanctions. In general, the regulations require credit unions to do the following:

- Block accounts and other property of specified countries, entities and individuals;
- Prohibit or reject unlicensed trade and financial transactions with specified countries, entities and individuals; and
- Report blocked assets and keep records of blocked transactions.

While not required by specific regulation, NCUA expects that a credit union will establish and maintain an effective, written OFAC compliance program commensurate with its OFAC risk profile (based on products, services, members and geographic locations). The program should identify higher-risk areas, provide for appropriate internal controls for screening and reporting, establish independent testing for compliance, designate a credit union employee or employees as responsible for OFAC compliance and create training programs for appropriate personnel in all relevant areas of the credit union. A credit union's OFAC compliance program should be commensurate with its respective OFAC risk profile.

The credit union's policies, procedures and processes should address how the credit union will identify and review transactions and accounts for possible OFAC violations, whether conducted manually, through interdiction software or a combination of both. The requirements extend to members and non-members alike.

RESEARCH TIP: More details about the OFAC compliance program and risk assessment requirements can be found in the OFAC section of the FFIEC Manual. OFAC's website also contains a number of useful resources, including frequently asked questions.

Specially Designated Nationals and Blocked Persons List

For screening purposes, the credit union should clearly define its criteria for comparing names provided on the OFAC Specially Designated Nationals and Blocked Persons list (SDN list) with the names in the credit union's files or on transactions and for identifying transactions or accounts involving sanctioned countries. The SDN list refers to a list of "Specially Designated Nationals" (SDNs). SDNs are individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries (such as Iran and North Korea), as well as individuals, groups and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific. OFAC maintains the SDN list. The SDN list, which is built into many BSA/AML/OFAC software programs, is available on Treasury's website [here](). The credit union's policies, procedures and processes should also address how it will determine whether an initial OFAC match to the SDN list (sometimes referred to as a "hit") is a valid match or a false hit.

CHAPTER 4 — BSA, PRIVACY AND SECURITY

SECTION 2 — PRIVACY OF MEMBER INFORMATION

OVERVIEW

A credit union routinely obtains sensitive information from its members and consumers. A credit union must sometimes share that information to service its members. This information is extremely valuable, and some credit unions share or sell this information to third parties where permitted. If credit unions were unable to share information with any third parties, the U.S. financial system would grind to a halt. Credit card transactions would be impossible, ACH transactions would not be processed and credit reports would not exist.

With this sharing in mind, several privacy-related regulatory systems are in place to protect consumers from unscrupulous practices related to their information. These rules account for the fact that legitimate information sharing and gathering must occur. The rules often create general prohibitions with a few exceptions. This section will discuss the major rules that address privacy issues and provide resources to assist a credit union in its compliance efforts.

THE GRAMM-LEACH-BLILEY ACT

After passage of the Gramm-Leach-Bliley Act of 1999 (GLBA), federal financial regulators issued privacy regulations that required depository institutions, including credit unions, to create privacy policies and make disclosures to consumers regarding how depository institutions gathered and shared sensitive member information. Regulation P now implements the GLBA. In some cases, Regulation P gives consumers the right to opt out or prevent the sharing of sensitive member information to third parties.

General Principles

The CFPB's Regulation P may appear complex at first glance, but the framework of the rule is rather simple. A credit union must create privacy policies that describe the information that it gathers from members and shares with third parties. Credit unions must disclose this policy to new members and to all members on an annual basis. Generally, credit unions that wish to share sensitive information with nonaffiliated third parties must give affected members the right to opt out or block such sharing. This general right to opt out, however, is subject to three large exceptions that allow the credit union to share information in ways that are necessary to run its business.

Information Subject to the GLBA

Section 1016.3 defines three main categories of information: 1) personally identifiable financial information; 2) publicly available information; and 3) nonpublic personal information. Whether information is subject to the GLBA's protections depends on which category it fits in.

Personally Identifiable Financial Information. This is information that a credit union collects about a member in connection with providing a financial product or service. It includes:

- Information provided by the member during the application process, such as a name or address;
- Information resulting from the financial product or service transaction, such as payment history, loan or deposit balances, and credit or debit card purchase information;
- Information from other sources about the member obtained in connection with providing the financial product or service, such as from a consumer credit report;
- Information collected through an internet "cookie" (a device that collects information from a web server); or

> **EXAMPLE**
>
> The fact that an individual is a member of a credit union is personally identifiable financial information about that individual under the GLBA.

Publicly Available Information. This is information that a credit union reasonably believes is publicly available. This occurs where a credit union has taken steps to determine:

- That the information is of the type that is generally available to the public; and
- Whether the member has blocked the information from being made available to the general public if they have the ability to do so.

> **EXAMPLE**
>
> A member's phone number would be publicly available only if the credit union takes steps to determine that the phone number is listed in the white pages. Similarly, a credit union may consider all mortgage documents and assessed values to be publicly available if state and local laws require all that information be filed in the public record.

Nonpublic Personal Information. This is the category of information protected by the consumer privacy rule. Nonpublic personal information consists of:

- Personally identifiable financial information that is not publicly available information; and
- Lists, descriptions or other groupings of members, which may contain publicly available information about them, but either contain or are created using personally identifiable financial information that is not publicly available.

> **EXAMPLE**
>
> A list is considered nonpublic personal information if it is created based on member relationships, loan balances, account numbers or other personally identifiable financial information that is not publicly available.

People Protected by the GLBA

A **consumer** is defined as an individual who obtains or has obtained a financial product or service from a credit union that is to be used primarily for personal, family or household purposes. The protections of the GLBA do not apply to businesses and organizations, though state laws may provide similar protections. It is important to note that a consumer may be a member or nonmember of the credit union.

A **customer** is a consumer who has a **customer relationship** with the credit union. A customer relationship means a continuing relationship between a consumer and the credit union where the credit union provides one or more financial products or services to the consumer that are to be used primarily for personal, family or household purposes.

A consumer has a continuing relationship with a credit union when he or she:

- Is a member as defined in the credit union's bylaws;
- Is a nonmember who has a share, share draft, or credit card account with the credit union jointly with a member;
- Is a nonmember who has a loan that the credit union services;
- Is a nonmember who has an account with a credit union that has been designated as a low-income credit union; or

- Is a nonmember who has who has an account in a federally-insured, state-chartered credit union pursuant to state law.

A consumer does not have a continuing relationship (and, thus, no customer relationship) if the consumer is a nonmember and:

- The consumer only obtains a financial product or service in isolated transactions, such as using the credit union's ATM to withdraw cash from an account maintained at another financial institution or purchasing travelers checks; or
- The credit union sells the consumer's loan and does not retain the rights to service that loan.

EXAMPLE

A nonmember that solely conducts a transaction at a credit union's ATM would be a consumer but would not be a customer and would not have a customer relationship with the credit union.

While Regulation P requires the annual privacy notice to be sent to customers as defined above, this section will refer to members for clarity. However, it is important to remember that nonmembers may also be customers entitled to receive the annual privacy notice.

Regulation P recognizes that customer relationships terminate. A credit union is not required to provide its annual privacy notice to an individual who no longer has a customer relationship with the credit union (e.g., the individual is no longer a member of the credit union). But a credit union must continue to comply with any opt-out instruction of a former member.

Entities Shared with Under the GLBA

An **affiliate** of a credit union is any company that is controlled by or is under common control with the credit union. For example, affiliates include a federal credit union's credit union service organizations (CUSOs). NCUA states that a credit union is presumed to have a controlling influence over the management or policies of a CUSO if the CUSO is 67 percent owned by credit unions. A **nonaffiliated third party** is any person except a credit union's affiliate or a person employed jointly by the credit union and a company that is not the credit union's affiliate. Regulation P restricts the disclosure of nonpublic personal information to nonaffiliated third parties.

NAFCU NOTE

Credit unions that receive information about consumers from other organizations might review this NAFCU *Compliance Blog* post on Regulation P's limitations on the use of information that is shared by a third party.

Privacy Notices

Regulation P requires three types of privacy notices: the initial privacy notice, the annual privacy notice and, potentially, a revised privacy notice. The three notices have different timing triggers and slightly different delivery requirements, but all three notices have the same content requirements.

Content Requirements & the Model Privacy Form

Generally speaking, the privacy notices are intended to give members an understanding of what information is collected and disclosed, to whom it is disclosed and for what purpose, what disclosures the member can prevent by opting out of that sharing, and what measures the credit union takes to keep information secure. The specific content requirements can be found in section 1016.6.

Regulators created a model privacy form which can satisfy these requirements. The model privacy notice is a two-page disclosure form designed to allow consumers to easily compare the privacy practices of different financial institutions. Use of the model privacy form by credit unions is voluntary. However, a credit union that chooses to use the model privacy form in a manner consistent with the form's instructions will receive a safe harbor for compliance with Regulation P.

To rely on the safe harbor, credit unions must, among other requirements, present the model privacy form in a way that is clear, conspicuous and intact so a member can retain the content of the model form. Credit unions may not change the content of the form or add any information, except as specifically permitted by the form's instructions. The Model Privacy Form can be located in the Appendix to Part 1016.

MORE INFORMATION: Regulators also created an online privacy form builder that a credit union can use to build its privacy disclosures. The instructions for the form builder can be found here.

Initial Privacy Notice

Section 1016.4 requires a credit union to provide an initial privacy notice to its members when it establishes the customer relationship. A credit union may always deliver a privacy notice earlier than required. If an existing member obtains a new financial product or service, the credit union is not required to provide another initial notice to that member if the earlier notice accurately covers the product.

It must also provide the notice to consumers before it discloses information to a nonaffiliated third party unless it does so under an exception. The notice is not required to be provided to people who only meet the definition of a consumer if the credit union does not share their information except under certain exceptions, like in order to process the transaction.

In general, Regulation P requires that a credit union deliver a privacy notice so that the member can reasonably be expected to receive actual notice in writing or, if the member agrees, electronically. For a consumer who applies for membership through the credit union's website, the credit union may post the notice on the site and require the consumer to acknowledge receipt of the notice through the website as a necessary step to becoming a member.

EXAMPLE

The initial notice may be mailed or hand-delivered to a consumer with a membership agreement. The delivery requirement for the initial notice, however, cannot be met by simply posting the notice on the credit union's website.

Annual Privacy Notice

Generally, credit unions are required to provide an annual privacy notice to each member at least once during a 12-month period throughout the life of the customer relationship. Credit unions are permitted to define that 12-month period as long as it is applied consistently. For example, a credit union can use the calendar year as the 12-month period.

Like the initial notice, the annual notice must be delivered so the member can reasonably be expected to receive actual notice, in writing or, if the member agrees, electronically. A credit union may satisfy this requirement by mailing a printed copy of the notice to the member's last known address. The credit union can also provide the notice on its website to members who access financial products or services electronically and are required to acknowledge receipt in order to obtain the product and service. For annual privacy notices only, section 1016.9(c) provides for two other situations that might constitute a reasonable expectation of receipt by the member:

- The member uses the credit union's website to access financial products and services electronically and agrees to receive notices at the website, and the credit union posts the current privacy notice clearly and conspicuously on the credit union's website; or
- The member has requested that the credit union stop sending information to the member, and the current privacy notice is available to the member upon request.

Under the exception in section 1016.5(e), no annual notice is required where the credit union does not share information with third-parties in a way that triggers the member's opt-out rights and there have been no changes to the information sharing policies and practices which were last disclosed to the member. If a credit union qualifies for the exception, it is not required to provide annual privacy notices. If the credit union falls out of the exception by changing its privacy policy, it must begin sending annual privacy notices again under the timeframes in the rule.

NAFCU NOTE

This NAFCU *Compliance Blog* post discusses the exception, what must happen when a credit union no longer qualifies and the removal of the alternative delivery method from the rule.

Revised Privacy Notice

Under section 1016.8, if a credit union changes its policies and practices regarding disclosures to nonaffiliated third parties so that its most recent notice is inaccurate, then the credit union may not begin disclosing the information until it provides revised privacy and opt-out notices. This change could be sharing a new category of information, sharing with a new type of third party or sharing information about a former member who never had the chance to opt out.

EXAMPLE

If a credit union's prior notices stated that it does not share information with nonaffiliated third parties, other than through the exceptions, the credit union would need to provide a revised notice before it could change this practice and begin sharing with nonaffiliated third parties in ways that are not covered by the exceptions.

Providing Notices on Joint Accounts

A credit union may provide a single notice to two or more members who jointly obtain a financial product or service, with one exception. Under section 1016.9(i)(2), for loans, a credit union is required to provide an initial notice to each member or guarantor individually if the notice includes a right to opt out, which is discussed below.

Limitation on Disclosure and the Exceptions

Section 1016.10 of Regulation P generally restricts the disclosure of nonpublic personal information to nonaffiliated third parties, unless the member has been given the opportunity to opt out of that sharing. There are three exceptions to that limitation.

Right to Opt Out

Members have the right to opt out of the disclosure of their nonpublic personal information to nonaffiliated third parties unless an exception applies. Credit unions that wish to disclose information to nonaffiliated third parties must provide opt-out disclosures in their privacy notices describing the member's right to opt out of the disclosure and then provide a reasonable opportunity for consumers to opt out of those disclosures.

The opt-out disclosure must first inform the consumer that the credit union may share the member's information, that the member can opt out of that sharing and inform the consumer on how to exercise that right to opt out.

A reasonable opportunity to opt out depends upon the particular circumstances of the transaction and includes several factors, such as the means by which the credit union provides the initial notice, the methods a member may use to opt out, and the length of time the credit union waits after sending a notice before determining that the member has not opted out. A credit union may specify a particular method for opting out, provided that the method is reasonable for that member.

EXAMPLE

Regulation P states that if the notice is provided by mail, and the member can opt out by mailing a form or calling a toll-free number, 30 days to do so is a reasonable opportunity to opt out. Requiring members to prepare their own letters to opt out is not reasonable under the rule.

The opt-out notice provided to joint account holders must explain how the credit union will treat an opt-out direction by a joint account holder and must give one joint account holder the ability to opt out on behalf of all joint account holders. Other than for loans, a credit union only has to deliver the initial opt-out notice to one party of a joint account. Any of the joint account holders, however, can exercise the right to opt out.

Once the credit union provides the reasonable opportunity to opt out, it can begin sharing information about any members who did not exercise the right to opt out. If a member opts out at any time, the credit union must stop disclosing that information as soon as reasonably practicable. A member's direction to opt out is effective until he or she revokes it in writing, or if he or she agrees, electronically.

MORE INFORMATION: **There is no regulatory guidance on what "as soon as reasonably practicable" means. NCUA indicated that the rule is intended to be general and what is appropriate may depend on how quickly the credit union's operations and technologies are capable of processing the request.**

Processing and Servicing Transactions Exceptions

A credit union may disclose nonpublic personal information to nonaffiliated third parties under the exception for processing or servicing transactions in section 1016.14 without triggering the notice and opt-out requirements. The exceptions in section 1016.14 generally permit credit unions to disclose member information freely to carry out routine business transactions involving existing accounts. For example, a credit union may disclose nonpublic personal information to a nonaffiliated third party to:

- Service the credit union's mortgages;
- Prepare or mail account statements;
- Make account information available to the credit union's members on its website; or
- Collect a share draft.

Other General Exceptions

Section 1016.15 provides other exceptions to the notice and opt-out requirements that permit credit unions to disclose member information to nonaffiliated third parties. A credit union may disclose nonpublic personal information where a member has consented and does not revoke the consent to the specific disclosure. A credit union may also disclose nonpublic personal information under this exception to comply with a properly authorized subpoena or with federal, state or local laws. Other permissible arrangements under section 1016.15 include disclosures of information to:

- A nonaffiliated third-party software vendor to protect the confidentiality or security of the credit union's member records;
- A person acting in a fiduciary or representative capacity on behalf of the consumer;
- The credit union's auditors, attorneys and accountants;
- A consumer reporting agency in accordance with the Fair Credit Reporting Act; or
- A law enforcement agency in accordance with the Right to Financial Privacy Act.

Exception for Agreements with Service Providers and Joint Marketers

Section 1016.13 permits a credit union to disclose nonpublic personal information to nonaffiliated third parties that perform services or functions for the credit union without providing an opportunity to opt out. To do this, a credit union must satisfy two conditions. First, the credit union must describe the disclosure in its privacy notice. Second, the credit union must have an agreement with the recipient that prohibits it from using the information other than for the purposes for which it received the information and that it will maintain the confidentiality of the information.

Regulation P does not impose any particular requirements regarding the form, scope, duration or other terms of the parties' agreement, though case law in a credit union's jurisdiction might.

EXAMPLE

An example would include an agreement under which a credit union establishes a relationship with a broker-dealer who offers investment services to members on a list the credit union provides in exchange for payment for each successful referral. Under this agreement, the credit union and broker-dealer are jointly offering the investment services the broker-dealer is providing to members, creating a joint agreement under this exception.

Prohibition Against the Disclosure of Account Numbers

A credit union must not disclose an account number or similar form of access number or access code to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to members. This prohibition against disclosing account numbers for marketing purposes applies even under a joint agreement to market financial products or services permitted under section 1016.13. The disclosure of an encrypted account number, however, is not prohibited as long as the credit union does not disclose the key to decrypt the number.

MORE INFORMATION: Note that while there is an exception for encrypted account numbers, there is no exception for disclosing truncated account numbers.

FUTURE OF PRIVACY REGULATION

With the frequency of data breaches and the use of consumer data in the digital age, there is an expectation that additional data privacy requirements may be added in the future. For example, in 2018, credit unions with operations or members in Europe began evaluating the potential impact of the European Union's General Data Protection Regulation (GDPR) which was written with a broad reach. The GDPR places stricter privacy standards related to personally identifiable information and applies to the information collected, held, transferred or processed. NAFCU has a series of blog posts on this subject, and a detailed article (member only) on the GDPR was published in the NAFCU *Compliance Monitor*.

Meanwhile, California passed its own sweeping privacy legislation in 2018, the California Consumer Privacy Act (CCPA). The CCPA went into effect January 1, 2020, and implementing regulations went into effect in August 2020. California voters then passed a 2020 ballot referendum called the California Privacy Rights Act of 2020 that amended the CCPA. Colorado, Connecticut, Utah, and Virginia have passed their own data privacy legislation, and it is likely other states will pass similar privacy laws.

NAFCU NOTE

In 2019, NAFCU issued a privacy white paper detailing federal privacy requirements, the number of states considering privacy legislation and the growing need for the federal government to clarify and reduce compliance burden for credit unions around this issue.

It is important that credit unions understand the impact of privacy laws in varying jurisdictions and how those requirements compare to the GDPR and the GLBA, in order to avoid risk of litigation. Thus, credit unions may want to monitor this area of the law for ongoing developments; preparing for potential state law changes is crucial as many states consider legislation in this area.

RESEARCH TIP: Other useful online resources that should help with researching privacy issues are NCUA's Consumer Privacy webpage and the FDIC's Model Privacy Form Compliance Guide.

AFFILIATE MARKETING RULE

The affiliate marketing rule is a privacy provision in the Fair Credit Reporting Act (FCRA) and implemented in Subpart C of Regulation V. The rule restricts credit unions from sharing certain information with affiliates for marketing activities.

MORE INFORMATION: An affiliate marketing flowchart walking through the rule's application is included as an attachment to this section.

Key Provisions

If a credit union and its affiliate are covered, neither may use eligibility information received from the other to make a solicitation for marketing purposes unless: 1) the information sharing practice is disclosed to the member; 2) the member has a reasonable opportunity to opt out; and 3) the member does not opt out. These elements are discussed below in additional detail.

Key Terms

Affiliate. The rule applies to all credit unions with an affiliate. An affiliate is defined in section 1022.3(b) as "any company that is related by common ownership or common corporate control with another . . . ." There is a presumption that a credit union has a controlling influence over a CUSO if credit unions own at least 67 percent of the CUSO.

There is virtually no difference between the Regulation V and the Regulation P definitions of affiliate. Therefore, if a credit union's privacy disclosures note the existence of an affiliate, it is very likely that the credit union comes within this rule's scope.

MORE INFORMATION: The regulators define affiliate in a way that subjects both the parent company and the affiliate to the regulation's restrictions. A CUSO is the affiliate of its credit union. The credit union, likewise, is an affiliate of the CUSO.

Eligibility Information. The rule only prohibits covered credit unions and their affiliates from using eligibility information for marketing purposes. Information which is not eligibility information is not covered by the rule.

The rule defines eligibility information as "any information which would be a consumer report if the exclusions from the definitions of consumer report [in the FCRA] did not apply." It does not include aggregate or blind data that does not include personal identifiers such as account numbers, names or addresses. The preamble to the final rule gives other examples of personal identifiers, such as social security numbers, driver's license numbers, telephone numbers and other types of information that when used together could identify a member.

Consumer Report. Since the definition of eligibility information is closely tied to a consumer report, it is worthwhile to revisit that definition. The FCRA defines consumer report as "any written, oral or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used in whole or in part for the purposes of serving as a factor in establishing the consumer's eligibility for" credit, insurance, employment or any other purpose authorized by the FCRA.

Solicitation. A solicitation is the marketing of a product or service initiated by covered credit unions and their affiliates to a particular member that is based on eligibility information provided by an affiliate. The marketing must be intended to encourage the member to purchase a product or service. The regulation indicates that solicitations such as telemarketing, direct mail or email would constitute solicitation if directed to a specific member based on eligibility information.

Conversely, solicitation does not include information directed at the general public and distributed without the use of eligibility information.

EXAMPLE

A classic example of this would be general marketing materials in the credit union's branches. Even if a CUSO created the advertisement, this rule would not govern it, as such ads are directed to the general public and do not use eligibility information as defined by the regulation.

Marketing Purpose. The term marketing purposes is not defined in the regulation. However, the regulation does indicate that an affiliate makes a solicitation for marketing purposes if it:

1. Receives eligibility information from an affiliate;
2. Uses it to:
   - Identify the member or type of member to receive a solicitation;
   - Establish criteria used to select members for solicitations; or
   - Decide which products or services to market to a member or tailor a solicitation to a member; and
3. As a result of the use, the member is solicited.

From this and the definition of solicitation, it seems reasonable to conclude that marketing purpose describes situations in which the credit union or its affiliate has attempted to sell a member a product or service.

Sharing Databases and the Use of Service Providers

Section 1022.21(b) clarifies that affiliates may share information in various ways, including when the credit union and the CUSO place data into a shared database. In addition, subject to certain exceptions, the credit union is deemed to have used an affiliate's eligibility information if a service provider acting on the credit union's behalf does so.

MORE INFORMATION: This Federal Reserve *Consumer Compliance Outlook* article provides an excellent summary of the affiliate marketing rule requirements.

Exceptions to the Restriction on Using Eligibility Information

There are exceptions to the general restriction against using eligibility information to make a solicitation where a covered credit union received it from an affiliate. The credit union may use eligibility information that it received from an affiliate in the following instances:

- To make a solicitation to a member with whom the credit union has a preexisting relationship;
- To facilitate communications to an individual for whose benefit the credit union provides employee benefits or other services through a contract with the employee related to and arising out of the current employment relationship;
- To perform services on behalf of an affiliate; however, if the affiliate is not allowed to make a solicitation to a member because the member opted out, then the credit union cannot send the solicitation on behalf of the affiliate;
- In response to a communication about credit union products and services initiated by the member;
- In response to an authorization or request by the member to receive solicitations; or
- If complying with the rule would prevent the credit union from complying with any provision of state insurance laws pertaining to unfair discrimination in any state where it lawfully does business.

The preexisting business relationship may be the most significant for credit unions. Section 1022.20(b)(4) defines a preexisting business relationship as "a relationship between a [credit union…] and a [member] based on":

- A financial contract between the credit union and the member which is in force on the date which the member is sent a solicitation;
- The purchase, rental or lease by the member of the credit union's goods or services, or a financial transaction between the credit union and the member, during the 18-month period immediately preceding the date on which the member is sent a solicitation; or

- An inquiry or application by the member regarding a product or service offered by the credit union during the three-month period immediately preceding the date on which the member is sent a solicitation.

Assuming the rule covers the credit union, and its information does not fall within one of the exceptions, the credit union must make certain disclosures and allow the member to opt out.

Affiliate Marketing Opt-Out Notice

The notice is required to be clear and conspicuous. Specifically, opt-out notices must identify, by name, the affiliate that is providing the notice. A group of affiliates may jointly provide the notice if it contains a list of affiliates covered by the notice. Appendix C to Regulation V contains model forms for notices by both single and multiple affiliates.

The affiliate that has the preexisting relationship with the member must send the notice, or two or more members of an affiliated group of companies may send it as a joint notice, if at least one has a preexisting relationship with the member. As neither the FCRA nor Regulation V specifies the notice must be in writing, the preamble to the final rule indicates that member consent in accordance with the E-SIGN Act is not required to provide notice electronically.

Section 1022.23(a)(2) indicates that credit unions may provide a single opt-out notice to joint account holders. The notice should indicate whether an opt-out by one member would be considered an opt-out by all joint account holders, or whether each must opt out separately. In addition, credit unions may not require all to opt out before honoring the opt-out request of one member. In other words, if the credit union permits each member to opt out separately, "one of the joint [members] must be permitted to opt out on behalf of all of the joint [members] and the joint [members] must be permitted to exercise their separate rights to opt out in a single response."

Reasonable Opportunity to Opt Out

Covered credit unions must give members a reasonable opportunity to opt out after delivery of the notice. The rule indicates that 30 days would be a safe harbor, also indicating that a longer or shorter period could be given in certain circumstances.

EXAMPLE

Section 1022.25 gives examples of reasonable opt-out methods such as including a toll-free number or self-addressed envelopes with the reply form. Conversely, requiring a member to write a letter or call or write to obtain an opt-out form is not reasonable.

Unlike Regulation P, a member's decision to opt out under the affiliate marketing rule may expire after five years under section 1022.22(b). In the case of an expiring opt-out, a credit union must send a renewal notice to the affected member with specific information. Section 1022.27 requires that the renewal notice indicate that the member had previously opted out, inform him or her that the opt-out has or will expire and give the member the means to opt out again.

Combining Notices

Regulation V allows opt-out notices to be coordinated and consolidated with other required notices or disclosures. That being said, there are important issues to consider when combining these disclosures. Financial regulators have indicated that if credit unions send a combined notice that contains both a permanent privacy opt-out under Regulation P and a limited opt-out under the affiliate marketing rule, the notice must be clear as to the affiliate marketing opt-out limitations.

The regulators also indicate that financial institutions could simplify matters by honoring a member's decision to opt out under the affiliate marketing rule in perpetuity. This would both simplify the initial notice and nullify the need for an affiliate marketing renewal notice.

Constructive Sharing

Constructive sharing is a way of structuring marketing activities with affiliates to achieve the same goals without triggering the affiliate marketing rule. Under a constructive sharing arrangement, an affiliate establishes a certain set of criteria. The other affiliate then determines who meets that criteria set and provides marketing materials or solicitations on its affiliate's behalf.

EXAMPLE

If a CUSO establishes criteria of members it would like to solicit, the credit union can create a list of members meeting those qualifications. The credit union would then send out the CUSO's marketing materials in periodic statements or other mailing. In this way, the marketing materials are sent to the desired members without sharing any private member information. This arrangement is not subject to the affiliate marketing rule, as no consumer information is shared among affiliates.

THE CAN-SPAM ACT

Prohibitions and Requirements

The Controlling the Assault of Non-Solicited Pornography and Marketing (CAN-SPAM) Act (15 USC § 7701 *et seq.*) is implemented by the FTC at 16 CFR Part 316. CAN-SPAM generally prohibits the use of false or misleading header information in credit union emails. Header information includes the address and domain and email is sent from and to, and the routing information.

It further requires certain unsolicited commercial emails to comply with additional requirements including:

- No deceptive subject lines;
- Include information identifying the email as an advertisement or solicitation;
- Include the credit union's physical postal address, which includes a current street address, a post office box or a private mailbox under certain circumstances;
- Include instructions on how the member can opt out of future emails through a functioning electronic return address or a comparable mechanism; and
- Honor any opt-out requests within 10 days.

If a credit union does not prepare electronic messages itself, but instead uses a third party to promote its services, it is still responsible for CAN-SPAM compliance and is required to take all reasonable steps necessary to ensure the third party does not violate CAN-SPAM requirements.

RESEARCH TIP: The FTC's [CAN-SPAM Rule webpage] is a good resource for more information.

Types of Messages Subject to CAN-SPAM Requirements

While the prohibition against deceptive headers applies to all emails, the other CAN-SPAM prohibitions and requirements only apply to commercial emails. An email is commercial under the rule when its primary purpose is the advertisement or promotion of a commercial product or service. CAN-SPAM looks at the content of an email to determine the email's primary purpose. CAN-SPAM divides email content into three potential categories:

- Commercial content – which advertises or promotes a commercial product or service, including content on a website operated for a commercial purpose;
- Transactional or relationship content – which facilitates an already agreed-upon transaction or updates a member about an ongoing transaction; and
- Other content – which is neither commercial nor transactional or relationship.

If the message contains only commercial content, its primary purpose is commercial. Therefore, it must comply with all of the requirements of CAN-SPAM.

Transactional or Relationship Emails

The primary purpose of an email is transactional or relationship if it consists only of content that:

- Facilitates or confirms a transaction that the member already has agreed to;
- Gives security information about a product or service;
- Gives information about a change in terms or features or account balance information regarding a membership, account, loan or other ongoing commercial relationship;
- Provides information about an employment relationship or employee benefits; or
- Delivers goods or services as part of a transaction that the member already has agreed to.

If the primary purpose of an email is transactional or relationship, it may not contain false or misleading header information, but is otherwise exempt from most provisions of the CAN-SPAM Act.

Mixed Message Content

It is common for emails sent by credit unions to mix commercial content and transactional or relationship content. When an email contains both kinds of content, the primary purpose of the message is the deciding factor. In guidance, the FTC provides the following test:

> If a recipient reasonably interpreting the subject line would likely conclude that the message contains an advertisement or promotion for a commercial product or service or if the message's transactional or relationship content does not appear mainly at the beginning of the message, the primary purpose of the message is commercial. Therefore, when a message contains both kinds of content – commercial and transactional or relationship – if the subject line would lead the recipient to think it is a commercial message, it will be a commercial message for CAN-SPAM purposes. Similarly, if the bulk of the transactional or relationship part of the message does not appear at the beginning, it is a commercial message under the CAN-SPAM Act.

MORE INFORMATION: Credit unions may also find it useful to review the FTC's CAN-SPAM Compliance Guide for Businesses and to watch the FTC's Video on Complying with CAN-SPAM.

RIGHT TO FINANCIAL PRIVACY ACT

Background and Summary

The Right to Financial Privacy Act of 1978 (RFPA) (12 USC § 3401 *et seq*.) became effective on March 10, 1979, and acknowledges that credit union members have a right to expect that their financial activities will have a reasonable amount of privacy from federal government scrutiny. The RFPA establishes:

- Specific procedures for government authorities to follow in seeking information about a member's financial records; and
- Limitations and duties on financial institutions before the release of information sought by government agencies.

MORE INFORMATION: **The RFPA was adopted principally in response to the decision in *United States v. Miller*, 425 U.S. 435 (1976), where the Supreme Court held that bank customers did not have a constitutionally protected privacy interest under the Fourth Amendment for financial records kept by a bank.**

The RFPA generally requires that the member receive:

- A written notice of the agency's intent to obtain financial records;
- An explanation of why the records are being sought; and
- A statement describing procedures to follow if the member wishes to withhold such records or information. Under certain circumstances, the notice may be delayed or waived.

Covered Customers

A customer is defined by the RFPA as any person, or his or her representative, who uses or is using any service of a bank with respect to an account held by the bank in the person's name. It also includes any person for whom the bank is acting, or has acted, as a fiduciary. However, a corporation or partnership of six or more persons does not constitute a customer. For credit unions, the definition of "customer" includes the credit union's members.

Covered Information

The RFPA's protections apply to the credit union's financial records. This includes any record held by the credit union pertaining to the customer's relationship with the credit union, or information derived from those records.

The RFPA excepts several kinds of records from this coverage. Among other exceptions, the RFPA does not apply to:

- Records that are not individually identifiable with a particular member.
- Records sought by a supervisory agency for its supervisory, regulatory or monetary functions such as examinations and investigations relating to consumer complaints.
- Records sought in accordance with IRS procedures.
- Records that are required to be reported in accordance with any federal statute or rule, such as the Bank Secrecy Act.

- Certain limited information that is requested by a government authority for a legitimate law enforcement inquiry.
- Records provided by the credit union to an appropriate law enforcement agency regarding any credit union officer, director, employee or any major borrower who there is reason to believe may be acting in concert with another officer, director or employee for criminal violation or violations of the Bank Secrecy Act and anti-money laundering statutes.

If the agency and the member are parties to a suit, records may be obtained under the Federal Rules of Civil and Criminal Procedure or the Administrative Procedure Act.

Government Authority Requests

To obtain access to the member's financial records, the RFPA requires, *with certain exceptions*, that the government authority obtain *one* of the following:

- An authorization, signed and dated by the member, that identifies the records being sought, the reasons for the request and the customer's rights under the RFPA;
- A search warrant, judicial subpoena, or administrative subpoena or summons that meets the requirements of sections 3405-3407 which, among other things, requires a copy to be appropriately mailed to or served on the member;
- A formal written request by a government agency that meets the requirements of section 3408, which, among other things, requires a copy of the request to be served on the member.

Note that each type of request involves some degree of notice to the member whose records are being sought. Under the RFPA, a credit union must begin to assemble the required information upon receipt of the summons or subpoena. The credit union must be prepared to deliver the records upon receipt of the written certificate of compliance. Credit unions may seek reimbursement for certain records provided by the RFPA. The reimbursement system is governed by the Federal Reserve's Regulation S.

RESEARCH TIP: **The Federal Reserve's RFPA Compliance Guide is a good resource when researching RFPA issues.**

Delayed Notice Requirements

The government may petition a court to authorize a delay in providing notice to members for an initial period of 90 days, if there is reason to believe that, among other things, providing a notice would result in:

- Endangering the life or physical safety of any person;
- Flight from prosecution;
- Destruction of or tampering with evidence;
- Intimidation of potential witnesses; or
- Seriously jeopardizing or unduly delaying an investigation, trial or official proceeding.

Further extensions can be provided for by the court.

Certification of Compliance Safe Harbor

The RFPA prohibits credit unions from releasing member's financial information to government authorities unless the authority has certified its compliance with the RFPA's requirements. When making a request, a government authority will certify that compliance to the credit union in writing. This certification is known as the certificate of compliance.

If a credit union releases information without a certificate of compliance, it may be liable for violating the RFPA, unless the sharing was subject to certain exceptions noted below.

Credit unions are under no obligation to look behind the face of the certificate to determine whether it is defective in some respect. If there is any defect in the government's request, the responsibility is that of the government; *the certificate of compliance provides the financial institution with a safe harbor against any possible civil liability under the RFPA*.

Exceptions to Certification Requirements

Under the RFPA, there are situations where information can be shared without receiving a government request and certificate of compliance.

For example, credit unions may notify law enforcement officials if it has information relevant to a violation of the law. This may include only the name or other identifying information concerning an individual, corporation or account involved and the nature of any suspected illegal activity. This section also provides the credit union with a safe harbor from litigation by the member.

Credit unions can also share information with the government in order to conduct certain typical business interactions.

EXAMPLE

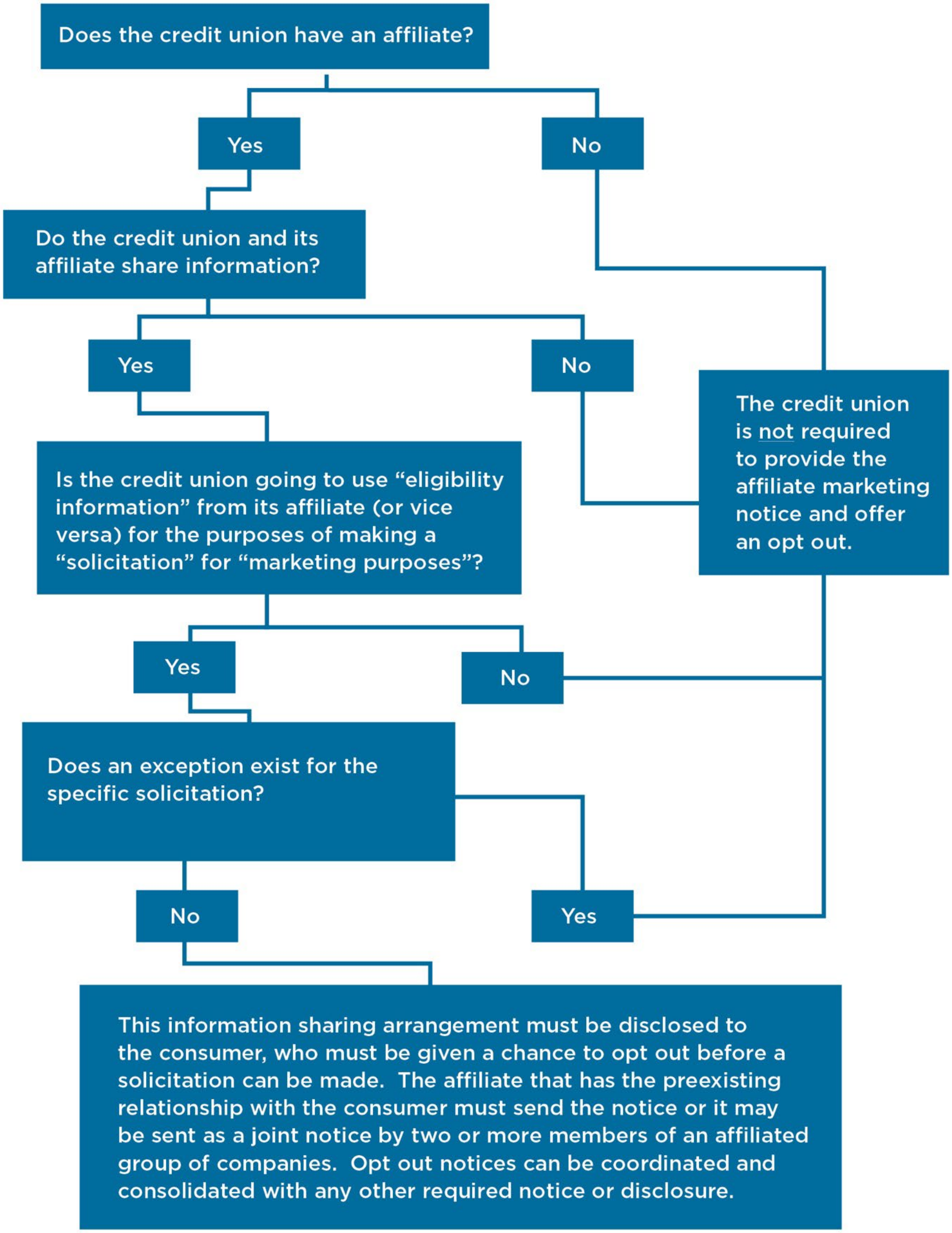
The RFPA permits sharing copies of records with the government to make a claim in bankruptcy or debt collection, to originate or service a loan insured under a government program, or to comply with federal laws like the BSA.

Record Retention

The credit union must maintain a record of all disclosures to a government authority pursuant to member authorization. The record should include the date, the name of the government authority and an identification of the records disclosed. Generally, the member has a right to inspect that record.

Although there are no specific record retention requirements in the RFPA, credit unions should retain copies of all administrative and judicial subpoenas, search warrants and formal written requests by federal government agencies or departments along with the written certification required to establish the safe harbor under the rule.

ATTACHMENT – AFFILIATE MARKETING



CHAPTER 4 — BSA, PRIVACY AND SECURITY

SECTION 3 — INFORMATION AND DATA SECURITY

NCUA'S SECURITY REGULATION

Currently, data breaches present one of the largest threats to credit unions. A credit union needs to protect itself, its records and the members' records in order to help ensure its safety and soundness as well as that of the National Credit Union Share Insurance Fund (NCUSIF). The Gramm-Leach-Bliley Act (GLBA), in addition to providing the consumer privacy protections discussed in Chapter 4, Section 2, also contains a "Safeguards Rule" which is implemented by NCUA in Part 748.

Written Security Program

NCUA's Part 748 requires credit unions to have a written security program in order to qualify for NCUA insurance. A credit union needs to protect itself, its records and the members' records in order to help ensure its safety and soundness as well as that of the NCUSIF. A federally-insured credit union must have a written security program within 90 days of the effective date of it being granted coverage under the NCUSIF.

Under section 748.0, a federally-insured credit union must have a security program designed to:

- Protect the credit union from robberies, burglaries, larcenies and embezzlement;
- Ensure the security and confidentiality of member information;
- Respond to incidents of unauthorized access to member information;
- Assist in the identification of persons responsible for physical threats to the credit union as well as attempts to access unauthorized member information; and
- Prevent destruction of vital credit union records.

These five bullet points provide the framework for a credit union's written security program, which should be tailored to the credit union's own unique facts and circumstances. The credit union's board of directors and senior management will need to analyze potential risks and formulate appropriate risk management techniques to mitigate those risks as well as determine action steps to be taken if the credit union's security is compromised.

Filing of Reports

NCUA requires each credit union to file three types of reports. Specifically:

- The credit union's president or managing official must certify compliance with Part 748 on an annual basis via NCUA's Credit Union Online Profile;
- A credit union must send a Catastrophic Act Report to its Regional Director within 5 business days of any catastrophic act impacting the credit union; and
- SARs must be filed, when appropriate under the BSA requirements.

MORE INFORMATION: The SAR reporting requirement and the procedures for BSA compliance in section 748.2 are discussed separately in Section 1 of this chapter.

Catastrophic Act Reports and Business Continuity Planning

Under section 748.1(b), a federally-insured credit union is required to notify its Regional Director within five business days of any catastrophic act that occurs at the credit union. A catastrophic act is defined as any disaster, natural or otherwise, resulting in physical destruction or damage to the credit union or causing an interruption in vital member services projected to last more than two consecutive business days. As soon as reasonably possible, the credit union should make a record of the incident – including information indicating where the catastrophic act occurred; when it took place; the amount of loss, if any; whether any operational, mechanical, or technical deficiencies contributed to the incident; and what steps the credit union is taking to correct any deficiencies.

The credit union also needs to establish business continuity plans (BCP) to ensure the credit union is prepared for potential disruptions that could impact service to its members. This section will provide a brief sketch of the components of a credit union's BCP.

In Appendix B to Part 749, NCUA recommends that credit unions develop a program to prepare for a catastrophic act. A credit union's program should include:

- A business impact analysis to evaluate potential threats;
- A risk assessment to determine critical systems and necessary resources;

- A written plan addressing:
    - Persons with authority to enact the plan;
    - Preservation and ability to restore vital records;
    - A method for restoring vital member services;
    - Communication methods for employees and members;
    - Notification of regulators of a catastrophic act;
    - Training and documentation of training for all employees and volunteers; and
    - Testing and documenting the test results;
- Internal controls for reviewing the plan at least annually and revising the plan as necessary to reflect changes in the credit union's operations; and
- Annual testing.

MORE INFORMATION: In March 2020, the FFIEC updated its Interagency Statement on Pandemic Planning, which discusses challenges and considerations unique to preparing for a pandemic.

The FFIEC's Business Continuity Management Booklet

The FFIEC has also released a Business Continuity Management booklet as part of its IT Examination Handbook Infobase. The booklet assists examiners in evaluating a credit union's resilience to disruptions affecting the credit union's IT systems. It emphasizes that business continuity management is on ongoing, continuous process of assessing risk, planning responses, implementing processes and testing, not simply a planning exercise. It also specifies that a credit union's board and senior management are responsible for overseeing the business continuity management process, including establishing and updating policies, allocating sufficient personnel and resources to implement those policies, ensuring the BCP is independently reviewed and approved, and ensuring the BCP is tested regularly and that those tests are reviewed.

The booklet also walks a credit union through the process of doing a business impact analysis of the credit union, including assessing and prioritizing various critical business functions, identifying the potential impact of a disruption, identifying legal and regulatory requirements, estimating the maximum allowable downtime and acceptable levels of loss and estimating recovery time objectives. It also helps credit unions perform gap analysis and risk assessments using various threat scenarios and contains information for doing risk management and risk monitoring and testing, to complete the process.

NAFCU NOTE

In 2019, the FFIEC released an updated *Business Continuity Management* booklet. This NAFCU *Compliance Blog* post discusses the changes in the 2019 booklet.

Safeguarding Member Information

The GLBA's Safeguards Rule requires financial institutions to establish appropriate administrative, technical and physical safeguards to ensure the security and confidentiality of customer records and information. NCUA has established guidelines in Appendix A to Part 748 to implement this statute for credit unions. The guidelines require federally-insured credit unions to create and maintain a comprehensive written information security program.

Appendix A to part 748 states the credit union's information security program must be appropriate for the size and complexity of the credit union and its operations. The program needs to be designed to:

- Ensure the security and confidentiality of member information;
- Protect against any anticipated threats or hazards to the security or integrity of member information;
- Protect against unauthorized access to or use of member information that could be harmful or inconvenient to the member; and
- Ensure the proper disposal and destruction of member information.

RESEARCH TIP: Appendix A to Part 748 provides the details on safeguarding member information and Appendix B to Part 748 contains the requirements for response programs and member notification. Additionally, NCUA has published an IT Security Compliance Guide, which is intended to help credit unions comply with Part 748 and Appendixes A&B.

Risk Assessment and Steps to Manage and Control Risks

Appendix B explains the credit union's program must include a risk assessment, which identifies internal and external risks; assesses the likelihood and potential damage from those risks and reviews the ability of the credit union's policies and procedures to control identified risks.

The credit union also needs to write policies and procedures to manage and control the identified risks to member information. As discussed in Appendix A, policies and procedures should include these measures, as appropriate:

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- Creating access controls on member information systems, including limiting access to only authorized individuals and including authentication procedures controls;
- Restricting access to member information at physical locations (including buildings, computers and records storage facilities) to only authorized individuals;
- Encrypting electronic member information both while in transit and while in storage;
- Ensuring any changes to credit union systems are consistent with the credit union's information security program;
- Establishing dual control procedures, segregation of duties and employee background checks for employees with access to member information;
- Monitoring the credit union's systems to detect unauthorized attempts to access member information;
- Writing response programs which specify the actions the credit union must take when member information has been accessed by an unauthorized individual; and
- Establishing safeguards to protect member information from damage due to fire, water or technical failures.

The credit union needs to train its staff on how to implement the information security program. The credit union also needs to ensure that its recordkeeping and destruction of member records procedures are consistent with its information security program.

The credit union should regularly test the systems, controls, and procedures of the program. The frequency of these tests should be determined by the credit union's risk assessment. Importantly, the tests of the credit union's information security program should be conducted or reviewed by independent third parties or staff independent of those implementing and maintaining the program.

Reviewing and Adjusting the Information Security Program

The credit union's information security program should not be static. The program must change and be amended as the credit union's operations change. The credit union needs to monitor and evaluate the existing program and determine if any adjustments are necessary. There are numerous changes to the credit union that could trigger a review, and potential changes, to the credit union's program.

EXAMPLE

If the credit union switches core processors, it would need to ensure its program is reviewed and updated where appropriate. Similarly, if the credit union acquires a credit union via a merger or enters into new third-party relationships, the credit union will need to update its program to reflect the credit union's current operations.

In short, when the credit union makes substantial changes to its operations, the risks the credit union faces may also shift and the credit union needs to ensure its program properly analyzes and controls for those new or increased risks.

Annual Report to the Board of Directors

Under Appendix A, a credit union needs to provide a report to the board of directors (or an appropriate committee of the board) at least annually. The report should describe the overall status of the program and its compliance with Part 748. Specifically, the report should discuss: risk assessments; risk management and control decisions; third-party relationships; testing results; security breaches and the credit union's responses and recommendations for changes to the program going forward.

Oversight of Third Parties

NCUA requires credit unions to conduct due diligence when selecting and utilizing third-party service providers. In addition, credit unions must require that the contract include appropriate measures to ensure the third-party will sufficiently protect and properly dispose of member information. The credit union should review audits and summaries of test results and conduct other evaluations to determine the third-party's ability to protect member information from potential threats. Additionally, contracts with third-party service providers should impose requirements on the service provider in the event of unauthorized access to credit union members' information, such as a requirement to notify the credit union as soon as possible after such an incident.

MORE INFORMATION: For more information on third-party due diligence, please see the Section 4 of this chapter on vendor management.

Interplay with Credit Union's Privacy Policy

A credit union should be sure to include in its information security program details about the credit union's sharing of information with third parties according to its privacy policy. The credit union should know which third-parties it shares member information with and how each third-party uses the member information.

EXAMPLE

A mail house might use the credit union's member data to send marketing materials on the credit union's behalf while an insurance company may use the member information to market its own products to the credit union's members.

In order for the credit union's security program to be robust, the credit union will need to incorporate information about where it is sharing information in accordance with its privacy policy and how those third-parties, both affiliates and non-affiliates, are using the member information.

The FFIEC's Management Booklet

The FFIEC's Management booklet clarifies the level of board oversight expected with regard to IT policies. A credit union's board is required to provide oversight of the credit union's information security program. The board (or an appropriate committee of the board) must be involved in the written program by approving the finalized program and any changes to the program. Additionally, the board must oversee the development, implementation and maintenance of the program. It must also assign specific responsibility for implementation of the program and review reports from management.

While the board may delegate design, implementation and monitoring of specific IT activities to management or a committee, ultimately it remains responsible for overseeing all information technology activities and must have sufficient knowledge and training to be a "credible challenge" to management. The booklet defines a 'credible challenge" as a board being actively engaged in the process, asking thoughtful questions and using independent judgment. In order to exercise sufficient oversight, the credit union's board of directors must understand IT activities and risks. A board may therefore need training on IT issues so that it can effectively provide oversight.

Response Programs for Unauthorized Access to Member Information

As a crucial part of its information security program, NCUA requires credit unions to develop a response program to address incidents of unauthorized access to member information. The response program should address actions the credit union will take regardless of whether the breach occurred to the credit union's systems or that of a third-party provider.

NAFCU NOTE

In July 2022, NCUA issued a proposed rule that would impose new requirements on federally-insured credit unions. Under this proposal, credit unions would be required to file a report with NCUA within 72 hours of experiencing a "reportable cyber incident." For a discussion of this proposal, see this post in NAFCU's *Compliance Blog*. A final rule on this topic could be issued in 2023.

Components of a Response Program

NCUA has established guidelines for the response program in Appendix B to Part 748. The response program needs to address how the credit union will assess the nature and scope of an incident in order to identify what member information has been accessed and the extent of the breach. The credit union's response will need to take appropriate steps to contain and control the incident to prevent further unauthorized access. This action may include monitoring, freezing or closing affected accounts while preserving records and other evidence related to the unauthorized access or attempted access.

According to Appendix B, a credit union should notify its NCUA Regional Director as soon as possible after the credit union becomes aware of the unauthorized access. The credit union should also contact law enforcement personnel, as well as file a SAR where appropriate.

RESEARCH TIP: In Legal Opinion Letter 06-0332, NCUA clarified that incidents that pose little or no harm to a member do not require notice to NCUA. It also contains guidance for the form and content of these notices.

Member Notification

Notification to members is a key component of the credit union's response program. By providing timely notification, the credit union can manage its reputation risk as well as reduce its compliance and legal risks. Timely notification allows members to take affirmative steps to protect themselves against unauthorized transactions stemming from the misuse of their member information.

When the credit union becomes aware of an incident of unauthorized access it should conduct an investigation to determine the severity of the unauthorized access and which members have potentially been impacted. If the investigation indicates that misuse of its information about a member has occurred or is reasonably possible, the credit union should notify the affected members as soon as possible. In certain circumstances, law enforcement may provide a written request to the credit union to delay notification so as not to interfere with an ongoing investigation. In that rare case, credit unions should prepare to provide the notification as soon as possible after law enforcement ends its investigation or withdraws the request to delay.

If the credit union can determine precisely which member's information has been accessed and potentially misused (i.e., only members with credit card accounts), the credit union can limit notification to those members. However, if the credit union cannot pinpoint which members are affected the notice should be sent to all members.

Contents of Member Notification

As described in Appendix B of part 748, the notice to members should describe the incident in general terms and indicate which member information may have been compromised by the unauthorized access. The notice should also indicate the steps the credit union has taken to mitigate the impact of the incident and how those actions will protect members.

EXAMPLE

The credit union might communicate that it has frozen certain accounts and will be reissuing new cards to members whose account numbers may have been compromised by the incident.

In addition, the notification should include the following information:

- A recommendation that the member review transactions and periodic statements and report any unauthorized transactions to the credit union;
- A description of fraud alerts and an explanation of how the member may place a fraud alert on their credit report;
- A recommendation that the member periodically obtain credit reports to review them for accuracy and prevent fraudulent accounts and transactions;
- An explanation of how a member can obtain a free credit report; and
- Information about the availability of the Federal Trade Commission's online guidance detailing steps the member can take to protect against identity theft.

The notice should be sent in a way the credit union can reasonably expect the member to receive it. In most cases, the credit union will be sending the notice by mail. The credit union could supplement this mailing with earlier telephone calls, website messages, emails or text messages to members to provide a more prompt notification. But providing the full disclosures over the telephone may not be practicable, and the electronic delivery only meets the notice requirement if the member has agreed to receive the communication electronically.

RESEARCH TIP: **There may also be state-specific requirements in the event a credit union experiences a data breach. This interactive map of state breach response laws may be helpful. A credit union should consult with its local counsel to determine whether it is subject to any state-law requirements.**

CYBERSECURITY GUIDANCE

As financial institutions are increasingly dependent on information technology and telecommunications to deliver services to consumers, the threat of disruption of those services or of degradation or theft of member information as a result of those services has increased in importance across the financial services industry. The FFIEC has produced two important cybersecurity resources for credit unions: the FFIEC IT Examination Handbook Infobase and the FFIEC Cybersecurity Assessment Tool.

FFIEC IT Examination Handbook Infobase

The FFIEC IT Examination Handbook Infobase is a collection of booklets hosted on the FFIEC's website. Two of these booklets were previously discussed: *Business Continuity Planning* and *Management*. The other nine include: *Audit*; *Development and Acquisition; Information Security;* Architecture, Infrastructure, and *Operations; Outsourcing Technology Services; Retail Payment Systems; Supervision of Technology Service Providers* and *Wholesale Payment Systems*. These booklets serve as the manual for NCUA IT examinations. What follows is discussion on some key areas.

The Audit Booklet

The Audit booklet describes the roles and responsibilities of the board and management, describes effective IT audits, and details examination objectives and procedures. The booklet states: "A well-planned, properly structured audit program is essential to evaluate risk management practices, internal control systems, and compliance with corporate policies concerning IT-related risks at institutions of every size and complexity." The *Audit* booklet describes an effective IT audit program as one that identifies the greatest areas of risk exposure, promotes confidentiality, integrity and availability of IT systems, determines the effectiveness of planning and oversight, evaluates the adequacy of current procedures, controls and compliance efforts, and requires appropriate corrective action of deficiencies.

The IT audit can be conducted by an internal audit function, an outside consultant or auditor, or a combination of both. External audits of IT controls are typically done within the context of a larger overall audit of a credit union such as a financial statement audit and should be clearly outlined in any engagement letter regarding the external audit. Because of the technical details involved in an IT audit, internal IT auditors should have information systems knowledge in line with the complexity of the credit union's IT systems. An IT auditor without sufficient knowledge and experience in IT systems may not be able to identify the root cause of deficiencies.

The Information Security Booklet

The Information Security booklet provides guidance to examiners on assessing the level of risk to a credit union's information systems. Information security refers to the process by which a credit union "protects the creation, collection, storage, use, transmission, and disposal of sensitive information, including the protection of hardware and infrastructure used to store and transmit such information." The goal of information security is to maintain confidentiality, integrity, and availability of information necessary for the credit union to conduct its business.

A credit union is required to have an information security program commensurate with its operational complexities and risk appetite. Examiners will review the credit union's information security program to determine whether it has sufficient protections against malicious cyber-attacks, including phishing and spear-phishing, malware, ransomware and denial of service (DoS) attacks.

The Architecture, Infrastructure, and Operations Booklet

The Architecture, Infrastructure, and Operations (AIO) booklet was published in July 2021, and replaced the FFIEC's previous Operations Booklet (first published in 2004). The AIO booklet is double the length of the previous booklet and is designed to focus on principles-based, enterprise-wide and process-oriented approaches to consider the design of technology within the credit union's overall business structure. The booklet can be broken down into each of the three elements in its title.

Architecture is defined in the booklet to cover "how credit unions design the use of hardware and software to achieve their business goals." This section discusses how architecture needs to be aligned with the credit union's business objectives and suggests that the architecture design process needs to be flexible to plan for usage of different hardware and software in the future. The booklet notes that architecture "should meet the [credit union's] needs for confidentiality, Integrity, and availability and adhere to the [credit union's] policies, standards, and procedures." The booklet discusses how to prepare for future changes to architecture, and discusses enterprise architecture, which Is analogous to enterprise risk management.

Infrastructure Is the hardware, software and other elements that should fit into the strategic architectural design laid out by the credit union. The booklet walks through the essential components of IT Infrastructure and provides tips on how management can keep each component safe and secure. Components discussed Include hardware (the physical element of an IT system), the network (which send data through Interconnected components), telecommunications (Including voice and data communications), software, environmental controls (such as HVAC systems, power, and smoke and fire detectors) and physical access controls (preventing unauthorized access to the credit union's facilities, physical assets or technology assets).

Finally, operations are "activities comprising methods, principles, processes, procedures and services that support business functions." According to the booklet, operations also describe the back-office functions and "encompass the day-to-day processing and support functions, service delivery and service management, and control processes to support both the operations and overall mission of the entity."

The booklet also provides a discussion of evolving technologies - how they affect AIO and risk and certain risk and control principles relating to them.

NAFCU NOTE

NAFCU has reviewed the AIO booklet in the *Compliance Blog*. This post provides an overview of the AIO booklet; this post discusses Architecture, and this post discusses Infrastructure.

FFIEC Cybersecurity Assessment Tool

The FFIEC's Cybersecurity Assessment Tool (CAT) is a voluntary tool a credit union can use to identify cybersecurity risks at the credit union and gauge the maturity of its cybersecurity controls. The CAT consists of two parts: Inherent Risk Profile and Cybersecurity Maturity.

The Inherent Risk Profile component identifies the inherent risk (before any controls or mitigations are in place) to the credit union's operations by looking at its types of technologies and connections, delivery channels, online and mobile product offerings, organizational characteristics and the external threats experienced by the credit union. The CAT lists an activity, service or product and the credit union selects the option that most closely fits it, which corresponds to a risk level. The risk levels are least, minimal, moderate, significant and most. Then the CAT assigns the credit union an inherent risk profile based on the risk level of those responses.

The Cybersecurity Maturity component assesses the credit union's controls and risk mitigations across five domains. The domains are Cyber Risk Management and Oversight, Threat Intelligence and Collaboration, Cybersecurity Controls, External Dependence Management and Cyber Incident Management and Resilience. In each domain, the credit union must answer "yes," "yes with compensating controls," or "no." "Yes with compensating controls" indicates that there is a management, operational or technical safeguard or countermeasure employed by the credit union, rather than the specific recommended security control listed in the question. The statements range from "baseline" maturity to "innovative" maturity, and the credit union's maturity for each domain is the highest maturity level where it answered all "yes" or "yes with compensating controls."

The "baseline" maturity level reflects the expectations for cybersecurity exams. While a credit union is not required to achieve any specific maturity level, a failure to meet baseline maturity may result in an examination finding. However, the goal of the CAT is not to determine whether a credit union is meeting basic requirements, it is to determine whether the credit union's risks are properly mitigated. If a credit union's profile shows the credit union operates at the highest risk levels, but its controls and risk mitigation steps are merely baseline, that incongruity may indicate a significant risk from cyber-attack to the credit union and its members.

NCUA's Information Technology Risk Examination Solution for Credit Unions (InTREx-CU)

NCUA has developed its own examination tool, the Automated Cybersecurity Examination Toolbox (ACET), which was based on the FFIEC's CAT. The ACET is now available as a self-assessment tool. Use of ACET is completely voluntary and ACET does not introduce any new regulatory requirements or expectations for credit unions. ACET can be used to help credit unions determine their level of cybersecurity preparedness.

In 2020, NCUA announced creation of the Information Technology Risk Examination for Credit Unions (InTREx-CU) as the new standard for NCUA's IT and cybersecurity examination procedures. The pilot for InTREx-CU launched in 2021. NCUA's 2021 Supervisory Priorities discussed InTREX-CU and noted that it aimed to harmonize the IT and cybersecurity examination procedures across the various federal and state financial regulators.

However, InTREx-CU was not mentioned in the 2022 Supervisory Priorities. In a June 2022 speech from NCUA Chairman Todd Harper stated that information gathered during the InTREx-CU pilot was used to make a *new* initiative known as the Information Security Examination (ISE), which "offers a measure of flexibility for credit unions of all asset sizes and complexity levels while providing examiners with standardized review steps that will facilitate advanced data collection and analysis." ISE involves three "work programs." The first group is credit unions with less than $50 million in assets; the second group is credit unions with greater than $50 million in assets, and the third group is known as "ISE Core Plus" and will focus on credit unions which need "expanded reviews and deeper dives into specific operational areas and security controls." According to Chairman Harper's June 2022 remarks, the ISE was scheduled for deployment at the end of 2022.

CFPB Cybersecurity Circular

In August 2022, the CFPB published Consumer Financial Protection Circular 2022-04. This policy statement advises that insufficient data protection or information security practices can violate federal law – specifically the Consumer Financial Protection Act's prohibition on unfair, deceptive and abusive acts or practices (UDAAP). In other words, poor cybersecurity practices can amount to a UDAAP violation.

The CFPB announced that inadequate data security measures can be an "unfair" act or practice because they can cause "significant harm to a few consumers or a small amount of harm to many consumers." Additionally, the Bureau said that inadequate data security which presents a significant risk of harm is enough to amount to a UDAAP violation, even if no actual data breach has occurred.

The circular discusses three data security practices that, if done poorly or not at all, could increase the likelihood of a UDAAP violation:

- **Multifactor Authentication**. Credit unions' cybersecurity practices are more likely to be a UDAAP violation if the credit union does not require its employees to use multifactor authentication or offer it as an option for members to access systems and accounts.
- **Password Management**. If a credit union does not have adequate password management policies and practices, then it is more likely its cybersecurity practices will be viewed as a UDAAP violation. The CFPB notes that adequate password management should include monitoring for breaches at other entities where employees may be re-using logins and passwords.
- **Timely Software Updates**. The CFPB circular states that cybersecurity practices are more likely to amount to a UDAAP violation if the credit union does not routinely update its systems. In addition to conducting routine updates, credit unions should also conduct updates when notified of a critical vulnerability.

Notably, the circular applies to credit unions (as "covered persons") as well as service providers, such as a credit union's vendors or CUSO.

CHAPTER 4 — BSA, PRIVACY AND SECURITY

SECTION 4 — VENDOR MANAGEMENT

OVERVIEW

A credit union often turns to third parties to expand its products and services. For example, credit unions often have vendor relationships with third-party product providers such as mortgage brokers, loan servicing providers, disclosure and document providers, external compliance and audit functions or technology providers.

The decision to use a third party can help a credit union meet its strategic goals, as outside vendors often have expertise and efficiencies that are not available within the credit union. All third-party relationships require oversight and it is the credit union's board of directors and senior management that is ultimately responsible for ensuring that there is a program in place for managing these types of relationships.

REGULATORY EXPECTATIONS FOR VENDOR MANAGEMENT

As regulators, the NCUA, FFIEC and CFPB all recognize the benefits of working with third parties. At the same time, these regulators expect credit unions to manage third-party relationships to control the associated risks.

In Letter to Credit Unions 07-CU-13, NCUA outlined its expectations for risk analysis and due diligence. Since then, NCUA has continued to build on the theme of third-party due diligence in numerous guidance letters to credit unions.

The FFIEC has issued its Outsourcing Technology Services booklet as part of its IT Examination Handbook Infobase. This examination guidance discusses the specific expectations for outsourcing technology services. Several parts of this guidance are highlighted in this section, but it is not exhaustive. Credit unions outsourcing technology services to a third party should consult the booklet in full for more detail.

Finally, the CFPB released Bulletin 2012-03, which defines its expectations for third-party relationships regarding those institutions and service providers it supervises directly. It also addresses UDAAP considerations for business arrangements with service providers. The bulletin was amended and reissued as Bulletin 2016-02.

MORE INFORMATION: The Federal Reserve's *Consumer Compliance Outlook* issued two articles on vendor risk management best practices which may be helpful: "Vendor Risk Management" and "Vendor Risk Management – Compliance Considerations."

Each regulator's requirements differ slightly, but generally contain four risk management steps credit unions must perform when establishing third-party relationships. Successful vendor management requires risk assessment and planning, due diligence in the selection of the third-party, contract management and ongoing monitoring and review.

Potential Risks

NCUA examines for seven areas of risk to credit unions: credit, liquidity, interest rate, transaction, compliance, strategic and reputation risk.

MORE INFORMATION: For more information on the seven areas of risk, see Chapter 1, Section 4.

Below are examples of how vendor relationships can touch on all seven areas of risk. For that reason, both NCUA and the FFIEC recommend that assessments and reviews of third-party relationships should consider all seven areas.

› *Credit, Liquidity and Interest Rate Risk*: inability of vendor to meet its contractual obligations; processing errors leading to mistaken investment, liquidity or pricing decisions.
› *Transaction Risk*: problems with service or product delivery; loss from failed processes or systems; inability to detect fraud or errors.
› *Compliance Risk*: violations of laws, rules or regulations; noncompliance with policies or procedures.
› *Strategic Risk:* inadequate experience or expertise leading to failures to properly identify, understand or control key risks;
› *Reputation Risk*: dissatisfied members; violations of laws or regulations that could lead to public enforcement actions.

The more critical a vendor is deemed to be; the more risk the relationship poses to the credit union. Therefore, the more critical the vendor, the more planning, due diligence and monitoring is required. Generally speaking, vendors that are essential to the daily function of core services are likely to be "highly critical;" vendors that are essential to core services but where there is an alternative means of delivery may be considered "critical;" and vendors that do not affect core service if not functioning might be "non-critical." Most credit unions will find the majority of the credit union's vendors are non-critical, but no matter what the finding is, the credit union should document how it came to that decision.

EXAMPLE

A credit union is looking to find a vendor to provide paper for its copiers. In addition, it is considering a vendor to manage its internet banking product. The copier vendor selection process might be non-critical whereas the internet banking vendor might be highly critical.

Effective risk assessment, control, and ongoing monitoring and review are required to mitigate the risks associated with a vendor relationship.

RISK ASSESSMENT AND PLANNING

NCUA Expectations

Before entering into a third-party relationship, NCUA expects a credit union to determine whether using a third party complements its overall mission and philosophy. During this phase, credit union officials should weigh the costs and benefits of outsourcing business functions. To do so, a credit union should understand its own strengths and weaknesses. NCUA stressed that credit unions should consider the following:

- Expectations for outsourced functions;
- Credit union staff expertise;
- The criticality or importance of the outsourced activity;
- Insurance considerations;
- The impact on membership should the credit union use a third-party;
- An exit strategy for the relationship; and

- The use of financial projections to gauge the credit union's return on its investment and whether the benefits of the proposed relationship outweigh the potential risks and costs.

MORE INFORMATION: A great tool for assisting with the risk assessment and planning is NCUA's Third-party Relationships AIRES Questionnaire. This questionnaire was used by examiners to determine whether a vendor relationship was properly assessed, chosen and monitored. Note, the AIRES questionnaires are being retired but the information will be incorporated into NCUA's modernized exam tools.

FFIEC Expectations for Outsourcing Technology Services

When it comes to outsourcing IT services, credit unions are not only expected to comply with NCUA's guidance, but the FFIEC's IT examination guidance as well. The Outsourcing Technology Services booklet discusses expectations for risk assessment and the requirements definition phase.

The FFIEC expects that, prior to engaging a third-party vendor, management at the credit union should assess the risk posed by outsourcing, establish written requirements to control the outsourcing process and use those requirements to guide and manage outsourcing at the credit union.

The amount of risk associated with outsourcing a function depends on several factors, including:

- The sensitivity of data accessed, protected or controlled by the service provider;
- The volume of transactions; and
- The criticality to the financial institution's business.

There can also be risks associated with the potential vendor, such as its:

- Strength of financial condition;
- Turnover of management and employees;
- Ability to maintain business continuity;
- Ability to provide accurate, relevant and timely information and services;
- Experience with the function outsourced;
- Reliance on subcontractors;
- Location; and
- Redundancy and reliability.

Finally, there may also be risks pertaining to the nature of the service obtained from the vendor, such as the reliability, security and scalability of the technology used.

RESEARCH TIP: The FFIEC's IT Examination Handbook Infobase, including the Outsourcing Technology Services booklet, the Supervision of Technology Service Providers booklet and the Audit booklet all contain additional information that might be relevant to credit unions.

Requirements Definition Phase

The requirements definition phase is a process that determines what the credit union needs in order to safely meet its business objectives. The requirements are defined through a process that identifies what functions or activities need to be outsourced, assesses the risks of outsourcing and establishes a baseline on which the credit union can build controls for that risk. Essentially this is the process of determining what the credit union's needs are, both in terms of the nature, standards and characteristics of the service being provided by the vendor and in terms of the appropriate controls, monitoring and reporting that need to be agreed upon so outsourcing can be safely done. This may include determining what contractual provisions would be appropriate for a vendor relationship, including an appropriate duration, conditions for termination, ownership of data and systems involved, as well as provisions regarding indemnification, insurance and limitations of liability.

The FFIEC states that at the conclusion of the definition phase, a detailed document containing the description of the credit union's expectations regarding outsourcing an individual service or function should be produced. This detailed documentation should be used in identifying appropriate vendors and performing subsequent reviews.

DUE DILIGENCE FOR THIRD-PARTY RELATIONSHIPS

NCUA, the FFIEC and the CFPB all explicitly require sufficient due diligence of potential third-party relationships. While there is no single way to perform that due diligence, there are some general principles: less complex risk profiles and vendor arrangements typically require less analysis and documentation; more complex risk profiles and vendor arrangements will require more analysis and documentation; and, if a credit union has a longstanding relationship with the vendor, less analysis may be required to renew the relationship.

NCUA Expectations

Due diligence should be tailored to the complexity of the third-party relationship.

RESEARCH TIP: NCUA has issued letters to credit unions discussing due diligence in several contexts including indirect lending (10-CU-15), outsourced lending functions in general (04-CU-13), mortgage brokers and correspondents (08-CU-19), investment activities (10-CU-18), payment service providers (10-CU-26) and third parties generally (01-CU-20).

The following due diligence practices are recommended by NCUA:

- Conducting a background check to review factors such as performance with other financial institutions, compliance with required licenses and certifications, and the existence of lawsuits and other legal proceedings involving the third-party;
- Understanding the third-party's business model, as well as its sources of income and expenses;
- Understanding how cash flows move between all parties in the proposed relationship;
- Reviewing the third-party's financial and operational condition, potentially including standardized auditing reports such as the SSAE 18/ISAE 3402;
- Having legal counsel with the appropriate level of expertise and experience review the contract that covers the proposed relationship; and
- Considering how the relationship may affect the credit union's accounting.

MORE INFORMATION: The SSAE 18 is a set of independent auditing standards established by the American Institute of Certified Public Accountants to look at an organization's risk management process and internal controls. It replaced the SSAE 16 in 2017. An SSAE 18 audit would result in the creation of a SOC report. The ISAE 3402 is an alternative to the SSAE 18.

Because a credit union is ultimately responsible for the regulatory compliance of its vendors, credit unions should also be familiar with the vendor's internal controls and ongoing monitoring for compliance.

NAFCU NOTE

For additional details on constructing a safe and sound vendor management program, see this past NAFCU *Compliance Monitor* article (member only).

FFIEC Expectations for Outsourcing Technology Services

Once the credit union has assessed the risks in outsourcing a technology service function and defined its requirements for that outsourcing, the FFIEC recommends producing a request for proposal (RFP) describing the credit union's objectives, the scope and nature of the work to be performed, expectations for service, delivery timelines, control measures and any other requirements the credit union needs from a potential vendor. The FFIEC notes that the RFP should request that proposals submitted in response to the RFP examine whether the third party can satisfy the credit union's requirements along with the third party's fees for performing those services.

Proposals received in response to the RFP should be considered against the requirements established by the credit union. Once potential vendors are identified, due diligence should be performed on both the vendor's proposal and the vendor itself. Due diligence serves a vital purpose here: it permits the credit union to confirm and verify whether the third party can do what it says it can do in the RFP response and assess the third party's ability to address the credit union's requirements.

In addition to the areas discussed by NCUA, the FFIEC also specifies that due diligence on technology service providers should also look at the vendor's:

- Service delivery capability, status and effectiveness;
- Technology and systems architecture;
- Internal controls environment, security history and audit coverage;
- Insurance coverage; and
- Ability to meet disaster recovery and business continuity requirements.

The FFIEC also recommends looking closely at the philosophy, quality initiatives, culture and values of any potential vendor.

CFPB Expectations

The CFPB's due diligence requirements focus on ensuring that the third-party will not present unwarranted risks to consumers, rather than to the credit union. It expects financial institutions will verify that the service provider understands and is capable of complying with consumer financial laws. The bureau also expects that financial institutions will ensure there is appropriate training and oversight of employees or agents that have contact with consumers or that have compliance responsibilities. To accomplish this, the bureau expects financial institutions to request and review the vendor's relevant policies, procedures, internal controls and training materials.

MORE INFORMATION: For more information, take a look at CFPB Bulletin 2012-3 and CFPB Bulletin 2016-02. Both describe its expectation for overseeing service providers.

CONTRACT ISSUES

A strong contract is essential to properly managing a third-party relationship. While the FFIEC and CFPB discuss contract issues as a separate item, NCUA includes contract issues as function of due diligence. However, NCUA does highlight contract issues as of particular importance, so it is separated out here for its own discussion.

NCUA Expectations

All contracts should be negotiated and in writing and should cover the expectations and responsibilities of each party. Legal counsel with the appropriate experience and expertise should review contracts with vendors. In Legal Opinion Letter 08-0417, NCUA advised credit unions to have qualified legal counsel to review vendor agreements. This can be performed by in-house counsel if counsel is qualified to do so.

EXAMPLE

In light of the recent patent litigation by USAA (member only) regarding remote deposit capture (RDC) technology, credit unions that contract with mobile banking platforms that offer RDC may want to review their contract for provisions that indemnify the credit union against any intellectual property lawsuits connected with the platform.

NCUA encourages credit unions to negotiate their contracts with vendors, rather than accepting offered terms as standard. Contracts should address the nature and scope of the arrangement including the responsibilities of all parties, service level agreements, and provisions for performance reporting and auditing. It should also include provisions to protect the credit union such as penalties for lack of performance, insurance provisions, dispute resolution provisions, and clauses addressing default and termination of the agreement. Contracts should also contain provisions to ensure quality member service, such as provisions addressing member complaints, binding the vendor to compliance with law and regulation, and requiring appropriate data security and confidentiality.

Contract provisions that typically require review include:

- Contract terms;
- Automatic renewal and notification requirements;
- Required service levels;
- Disaster recovery capabilities;
- Fees; and
- Compliance with regulatory requirements.

FFIEC Expectations for Outsourcing Technology Services

The FFIEC's Outsourcing Technology Services booklet addresses many of the same contract terms addressed by NCUA, but with much more detail and within the context of outsourcing technology services.

Contracting for appropriate security and confidentiality is especially critical with regard to technology service providers. The contract should require compliance with appropriate federal and state laws. The booklet indicates any contract should also prohibit the vendor from disclosing information about the credit union's resources and systems, except as necessary to perform under the agreement. It should also protect the information of both the credit union and its members against unauthorized access or use and require full disclosure and corrective action of any breaches in security that do result in authorized access to that information.

The credit union may also need to establish provisions regarding appropriate audits of the vendor. This could include financial audits, internal control audits and security reviews. The contract should specify audit frequency, related charges, and the right to obtain reports and documentation of deficiency resolutions in a timely manner. Where internet-related services are involved, security audits and testing may also be necessary.

Business continuity planning, backup and record protection and disaster recovery should also be clearly outlined. The credit union should also receive a copy of the vendor's contingency plan and contract for specific recovery timeframes that meet the credit union's requirements.

CFPB Expectations

The bureau requires financial institutions to include in any contract clear expectations about compliance with consumer regulation. It also requires appropriate and enforceable consequences for violating any compliance-related responsibilities. This includes engaging in unfair, deceptive or abusive acts or practices.

RISK MEASUREMENT, MONITORING AND CONTROL

Vendor management is an ongoing process; it does not end after vendor selection and signing the contract. The level of vendor monitoring and review required depend on the credit union's risk assessment. As part of the overall vendor management process, it is important to have policies and procedures and controls in place to continue to monitor the third-party relationships at the credit union. In addition to addressing NCUA's expectations for monitoring and review, an annual review of the vendor's financial condition and insurance coverage is a standard practice.

An assessment of whether the vendor has successfully provided services as represented in the contract and in accordance with applicable laws and regulations is also an essential part of third-party monitoring and review. It is important that all parties to the arrangement, including the credit union, are fulfilling their responsibilities. Even where a contract provides that the vendor is responsible for compliance with regulatory requirements, this does not alleviate the credit union from liability if the vendor fails to comply with applicable regulatory requirements. The credit union is responsible for ensuring that the vendor is indeed complying with applicable regulations.

NCUA Expectations

NCUA expects credit unions to establish ongoing controls and monitoring once a third-party relationship has been established. This includes developing appropriate policies and procedures for ongoing oversight and the content and frequency of reporting to management and, if the outsourced function is "material," to the board.

Vendor performance should be measured, including the profitability, benefit and service delivery for the credit union. Where this information is self-reported by the vendor, the accuracy of information should be periodically verified.

A credit union must have the infrastructure to monitor a vendor, including appropriate staff, equipment and technology. Staff tasked with overseeing the vendor must be qualified to do so, exhibiting familiarity with and an understanding of the reports issued by the vendor. Consistent with the guidance, NCUA indicates that the control measures should be reflective of the inherent risks of the particular third-party.

FFIEC Expectations for Outsourcing Technology Services

The FFIEC expects credit unions to periodically rate service provider relationships according to risk in order to determine whether a particular vendor should receive closer monitoring. Third-party relationships with higher risk ratings should receive more frequent and stringent monitoring for due diligence, financial and operation performance and independent control validation reviews.

The booklet specifies that credit unions should verify the financial condition of technology services providers on an annual basis and report the results of that financial review to the board of directors or a designated committee. If a vendor's financial condition becomes unstable or is deteriorating, the credit union should implement a contingency plan.

Credit unions should review the vendor's internal and external audit reports and any control reviews conducted by qualified sources. The credit union may also need to conduct its own audit of the controls and operating procedures required by the credit union in its contract and service level agreements. Both the Outsourcing Technology Services booklet and the Audit booklet contain substantial information about appropriate audit techniques and requirements.

CFPB Expectations

The bureau expects credit unions to establish internal controls and on-going monitoring with regard to a vendor's compliance with federal consumer financial law. In the event that compliance deficiencies are identified, the bureau states the financial institution should take prompt corrective action, potentially including terminating the relationship.

UDAAP Considerations

Due to the CFPB's enhanced scrutiny of these relationships, more third-party practices may be categorized as unfair, deceptive or abusive acts or practices (UDAAP). Vendors may be heavily involved in delivering or selling products and services to a credit union's members. Without adequate monitoring, these risks will manifest most significantly through deceptive vendor marketing and other unfair, deceptive or abusive acts or practices.

EXAMPLE

In 2012, the bureau found that Capital One's call center vendors were deceptive in selling add-on products. The call center vendors used high-pressure, misleading sales tactics on consumers by not indicating the products were optional, cost money or by telling them that the products would improve their low credit scores or limits. Capital One was ordered to return approximately $140 million to consumers and to pay a $25 million civil penalty to the CFPB's Civil Penalty Fund.

CHAPTER 4 — BSA, PRIVACY AND SECURITY

SECTION 5 — CONTACTING MEMBERS - THE TCPA AND THE TSR

OVERVIEW

Congress passed the Telephone Consumer Protection Act (TCPA) in 1991 to address consumer privacy concerns for receiving unsolicited telemarketing and sales calls. In part, the TCPA restricts the use of an automated telephone dialing system (ATDS or autodialer) or artificial and prerecorded messages (robocalls) to cell phones and residential landlines, requiring consent for certain kinds of calls. The TCPA also restricts certain unsolicited advertisements sent to fax machines and has rules governing company-specific do-not-call registries.

The TCPA is implemented by the Federal Communications Commission (FCC) and, unlike some regulations, the TCPA rules are interpreted and clarified through orders. As a result, credit unions cannot rely solely on the regulatory text because the FCC has issued several orders over the years clarifying and revising its TCPA rules.

Meanwhile, recent court decisions have changed the TCPA landscape. The law is subject to frequent litigation given its rather high statutory penalties – $500 generally or even up to $1,500 per unlawfully placed call if egregious. Overall, when researching TCPA issues, it is important to look beyond the regulatory text to both the FCC's orders and court interpretations. Because of the role of case law in interpreting the TCPA, a credit union may even wish to consult with local counsel to see how some ambiguous terms are interpreted in the jurisdictions where a credit union operates.

RESEARCH TIP: The FCC's Small Entity Compliance Guide is a useful starting point for researching issues relating to the TCPA and the commission's TCPA regulation. This document has not been updated since the 2012 TCPA Order so it is important for compliance officers to not rely exclusively on this document for regulatory compliance. The TCPA rules can be found here and FCC major actions on TCPA can be found here.

RECENT TCPA ORDERS

Credit unions previously relied on an established business relationship exemption in the TCPA to make calls to members using an artificial or prerecorded voice. In 2013, an FCC order went into effect that removed this exemption from the requirement to have consumer consent for certain calls or texts made using an autodialer or by robocall.

Further complicating things, on July 10, 2015, the FCC issued the 2015 TCPA Order to address a variety of questions presented by a 2012 TCPA Order, such as: what constitutes an autodialer; how to establish consumer consent and how such consent may be revoked; and whether certain situations warranted exemptions to the consent requirement. Generally, the 2015 TCPA Order confirmed the rules set forth in a previous 2012 TCPA Order, and added a few exceptions to the express consent provision.

But the FCC's 2015 TCPA Order proved controversial and faced almost immediate legal challenges. In March 2018, the United States Court of Appeals for the DC Circuit (DC Circuit) issued a decision in a case titled *ACA International v. FCC* (*ACA International*) and invalidated parts of the order, including the commission's approach to defining an autodialer. In November 2022, the FCC issued an order declaring ringless voicemails subject to the robocalling rules.

NAFCU NOTE

This NAFCU *Compliance Monitor* article (member only) has more detail on the impact of ACA *International* on the current state of the TCPA. NAFCU also continues to advocate for TCPA reform for credit unions.

USE OF AUTODIALERS AND ROBOCALLS

The TCPA and its accompanying rules address phone calls made using technology covered by the act. They generally place certain restrictions on phone calls made using an autodialer or those that constitute a robocall (i.e., made using an artificial or prerecorded voice).

Definition of Autodialer

The TCPA and its rules define an autodialer as "equipment **which has the capacity** to store or produce telephone numbers to be called, using a random or sequential number generator, and to dial such numbers (emphasis added)." In the 2015 TCPA Order, the FCC adopted a broad interpretation of what constitutes an autodialer, which swept in a wide array of calling equipment and software. Specifically, the FCC interpreted capacity broadly to include equipment that has the **potential** ability to dial randomly or sequentially, for example, by modifying the equipment or adding software to provide those capabilities in the future.

This interpretation has since been invalidated by the *ACA International* case. As a result, the court overturned previous FCC orders, meaning all that remains is the original statutory definition of an autodialer.

In 2021, the United States Supreme Court resolved some of the uncertainty about what constituted an autodialer under the TCPA in *Facebook, Inc. v. Duguid*. There the Court held "that a necessary feature of an autodialer . . . is the capacity to use a random or sequential number generator to either store or produce numbers to be called." The Court, however, did not address what capacity means, and this ambiguity could lead to courts in different jurisdictions coming to different conclusions about what constitutes capacity. Even with the Supreme Court's opinion on what constitutes an autodialer under the TCPA, credit unions may want to speak with counsel to see how certain jurisdictions are dealing with the capacity issue.

Establishing Consent Under the TCPA

The TCPA's regulations require prior express written consent for all **telemarketing calls** to cell phones using an autodialer or by robocall and for all robocall **telemarketing calls** to residential lines. The TCPA also requires prior express consent for **informational calls** to cell phones using an autodialer or by robocall. It is a defense to a TCPA violation to demonstrate the credit union had the consent of the called party to make calls using an autodialer or by robocall. At this time, there is no regulatory interpretation of called party and it is up to courts to make determinations as to what this means.

Telemarketing is defined as the "initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person." As a general rule, any dual-purpose calls (i.e., calls that have both an informational and a telemarketing purpose) are considered telemarketing. Telemarketing **does not** include:

- Debt collection calls;
- Calls made by loan servicers regarding the servicing of a consumer loan or home loan modification;
- Providing a credit card balance; or
- Research and survey calls.

Rather, these kinds of calls are **informational**.

Under the TCPA regulations, prior express written consent, which is required for all telemarketing calls to a cell phone using an autodialer or an artificial or prerecorded voice (i.e., a robocall) and for telemarketing calls to a residential line by way of a robocall, requires a written agreement signed by the person who will receive the calls. This written agreement must clearly and conspicuously disclose to the consumer that:

- By signing the agreement, she authorizes the seller to deliver, to a designated phone number, telemarketing calls using an autodialer or an artificial or prerecorded voice; and
- The consumer is not required to sign the agreement, or agree to enter into it, as a condition of purchasing any property, goods or services.

RESEARCH TIP: While the 2015 TCPA Order was overturned in part, it provides an in-depth discussion of the FCC's TCPA regulation and the consent requirements for credit unions so it may be a useful resource for compliance officers looking for a deep-dive for background information about the TCPA. The 2012 TCPA Order also provides an in-depth discussion of the FCC's TCPA regulation and includes some helpful commentary on debt collection that may be of interest to credit unions.

What is Required For Prior Express Written Consent? (For Telemarketing Calls Only)

Identify

- Each specific seller to whom consent is being provided.
- The consumer's phone number.

Indicate

- An affirmative agreement (i.e., I agree/consent)

Disclose

- That the consumer is authorizing the seller to engage in advertising or telemarketing
- That the calls will be made using automated technology
- That the consumer is not required to provide consent as a condition of purchasing goods or services

Obtain

- A written signature from the customer (either electronically through E-SIGN or handwritten)

Unlike prior express written consent, prior express consent is not defined in the TCPA. In the original 1992 TCPA Order, the FCC suggested that providing a cell phone number to a creditor can reasonably evidence prior express consent required under the TCPA. One operational challenge in relying on this guidance may be demonstrating how a credit union obtained a particular cell phone number. In the event that there is a dispute over consent, the burden would be on the credit union to demonstrate that it had established prior express consent.

Here is a table outlining the varying types of consent based on the type of number called, the technology used and the purpose of the call:

Type of Number Called	Type of Technology Used	Purpose of the Call		
		Telemarketing	Informational	Emergency
Residential	ATDS	None	None	None
	Artificial or prerecorded	Prior express written consent	None	None
Cell Phone	ATDS	Prior express written consent	Prior express consent	None
	Artificial or prerecorded	Prior express written consent	Prior express consent	None

MORE INFORMATION: Subsection 64.1200(a)(3) explains what type of consent is necessary for informational calls using an artificial or prerecorded voice to any residential line. On February 25, 2021, proposed amendments to subsection 64.1200(a)(3)(ii) were published in the Federal Register. Those amendments indicate that three informational calls per month to a residential line using an artificial or prerecorded voice will be permissible without having the called party's prior express written consent. The amendments to section 64.1200(a)(3)(ii) have been delayed indefinitely until there is further notification published in the Federal Register. Until that time, the existing language in section 64.1200(a)(3)(ii) permits informational calls to a residential line using an artificial or prerecorded voice without having the called party's express consent regardless of the number of informational calls made in a month. If the amendments are implemented as currently drafted, making more than three informational calls per month to a residential line using an artificial or prerecorded voice will require the prior express written consent of the called party.

NAFCU NOTE

Please see this NAFCU *Compliance Monitor* article for more information about the different types of consent required under the TCPA and other operational challenges arising out of TCPA requirements (member only).

Revoking Consent

Under the 2015 TCPA Order, members can revoke previously provided consent for both informational and telemarketing calls. The order clarified a credit union may not control the method by which members can revoke consent. A credit union can suggest a method of revocation but cannot designate the exclusive method(s) members must use to revoke prior express consent. For example, a credit union cannot require members to submit their opt-out request in writing. Rather, "[members] have a right to revoke consent, using **any reasonable method** including orally or in writing.

EXAMPLE

The FCC provided the following example of reasonable revocation of consent: "Consumers generally may revoke, for example, by way of a consumer-initiated call, directly in response to a call initiated or made by a caller, or at an in-store bill payment location, among other possibilities."

Courts have upheld the "any reasonable method" standard. As a result, credit unions may want to have methods for tracking revocation of consent so that future calls are not placed to the member.

Judicial interpretation is also a wildcard here. Some courts opine that members cannot unilaterally revoke consent that was bargained-for in an enforceable contract. Other courts go in the other direction and permit members to revoke even if it is a bargained-for contractual term. Credit unions may wish to consult with counsel to see how this split of authority may affect the credit unions' operations given their unique footprints.

Limited Exemption for Certain Calls

The 2015 TCPA Order created an exemption for certain free-to-the-consumer (or "free to end user") calls and text messages by financial institutions that used an ATDS or an artificial or prerecorded voice. A credit union could make these calls without the member's consent if the recipient is not charged for the call or text (i.e., the calling party pays for the call or text message). The order exempts the following four types of free-to-the-consumer calls:

- Calls intended to prevent fraudulent transactions or identity theft;
- Data security breach notifications;
- Measures consumers may take to prevent identity theft following a data breach; and
- Money transfer notifications.

To take advantage of the exemption, the following conditions must be met:

- Voice calls and text messages must be sent, if at all, **only to the wireless telephone number provided by the member**. Thus, a credit union cannot employ skip tracing programs or other forms of data mining to obtain the number;
- Voice calls and text messages must state the name and contact information of the credit union (for voice calls, these disclosures must be made at the beginning of the call);
- Voice calls and text messages are strictly limited to the four permissible purposes and must not include any telemarketing, cross-marketing, solicitation, debt collection or advertising content. So make certain the content does not include any mixed messaging;
- Voice calls and text messages must be concise, generally one minute or less in length for voice calls (unless more time is needed to obtain member responses or answer member questions) and 160 characters or less in length for text messages;
- A credit union may initiate **no more than three messages** (whether by voice call or text message) **per event** over a three-day period for an affected account;
- A credit union must offer members an **easy means to opt out of future such messages within each message**; voice calls that could be answered by a live member must include an automated, interactive voice- and/or key press-activated opt-out mechanism that enables the member to make an opt-out request prior to terminating the call; voice calls that could be answered by an answering machine or voice mail service must include a toll-free number that the member can call to opt out of future calls; text messages must inform members of the ability to opt out by replying "STOP," which will be the exclusive means by which consumers may opt out of such messages; and **a credit union must honor opt-out requests immediately**.

One challenge for actually utilizing this exception is the way the FCC frames what constitutes a "free to end user" call. The FCC explained that these are calls or texts that "are not charged to the recipient, including not being counted against any plan limits that apply to the recipient (e.g. number of voice minutes, number of text messages) . . . ." In other words, it does not seem to be sufficient that the member receiving the call or text has an unlimited wireless plan. This free to end user exemption, along with others for things like package deliveries, inmate collect call service providers and healthcare providers, is now codified in section 64.1200(a)(9) of the TCPA regulations.

Reassigned Numbers Database

The FCC issued an order in 2018 that provided for a safe harbor from TCPA liability for callers that elect to incorporate usage of a reassigned numbers database into their procedures. To qualify for the safe harbor, a caller "must demonstrate that they appropriately checked the most recent update of the database and the database reported 'No' when given either the date they contacted that consumer or the date on which the caller could be confident that the consumer could still be reached at that number." If there is ever a question about whether a caller checked the reassigned numbers database before making a call, the order indicates that the caller must prove it did so. The reassigned numbers database is now operational, and the database website includes subscription and pricing information.

REQUIREMENTS REGARDING COMPANY-SPECIFIC DO-NOT-CALL LISTS

The FCC's TCPA rules also prohibit telemarketing calls to residential telephone subscribers unless the credit union has procedures for maintaining a company-specific do-not-call registry. This prohibition equally applies to telemarketing calls to cell phones. A credit union making telemarketing calls, or who contracts with someone to make telemarketing calls on behalf of the credit union, must have a written policy for maintaining the do-not-call registry and train personnel engaged in telemarketing regarding the existence and use of the do-not-call list. The credit union (or its vendor) must also provide the called party with the name of the caller, the name of the credit union on whose behalf the call is being made (if applicable) and a telephone number or address at which the credit union may be contacted.

Do-Not-Call Requests from Consumers

If the credit union is engaged in making telemarketing calls and receives a do-not-call request from a residential telephone subscriber, the credit union must record the request and place the subscriber's name and telephone number on the do-not-call list at the time the request is made. The credit union must honor the request within a reasonable time from the date such request is made, but no later than 30 days from the request. The credit union must also maintain a record of the subscriber's request and honor the request for five years from the time the request is made.

If the request is recorded or the do-not-call list is maintained by a vendor, the credit union will be liable for any failures to honor the do-not-call request. Furthermore, the credit union must obtain the subscriber's prior express permission to share or forward the subscriber's request not to be called to a party other than its vendors and affiliates. A do-not-call request will typically not apply to affiliates unless the subscriber reasonably would expect them to be included given the identification of the caller and the product being advertised.

EXAMPLE

The request may apply to a closely-affiliated credit union service organization, but may not apply to an insurance company that occasionally does business with the credit union.

OTHER RESTRICTIONS ON TELEMARKETING CALLS

The rule also places certain time, place and manner restrictions on telemarketing calls and telephone solicitations. A telephone solicitation is defined as "the initiation of a telephone call or message for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services, which is transmitted to any person." The definition has limited exceptions for calls made with the called party's prior express permission or calls to any person with whom the credit union has an established business relationship.

Restrictions on Telephone Solicitations

A credit union may not make telephone solicitations to any residential telephone subscriber before 8 a.m. or after 9 p.m. local time at the called party's location, or call any residential telephone subscriber who has registered his or her telephone number on the national do-not-call list. A do-not-call registration on the national do-not-call registry must be honored indefinitely, or until the registration is cancelled by the subscriber.

MORE INFORMATION: Like the company-specific do-not-call requirements described in section 64.1200(d) of the TCPA regulations, these restrictions on telephone solicitations to any residential telephone subscribers apply to cell phones as well.

Regardless, credit unions will not be liable for calling a member who is on the national do-not-call list if they can demonstrate that the violation was the result of an error and that in their routine business practices, they meet the following standards:

- **Written Procedures.** The credit union has established and implemented written procedures to comply with the national do-not-call rules;
- **Training of Personnel.** The credit union has trained its personnel, and an entity assisting in its compliance, in procedures established pursuant to the national do-not-call rules;
- **Recording.** The credit union has maintained and recorded a list of telephone numbers that the credit union or its vendors may not contact;
- **Accessing the National Do-Not-Call Database.** The credit union uses a process to prevent telephone solicitations to any telephone number on any list established pursuant to the do-not-call rules, employing a version of the national do-not-call registry obtained no more than 31 days prior to the date any call is made, and maintains records documenting this process.
- Purchasing the National Do-Not-Call Database. The credit union purchases access to the database from the administrator of the national database and does not enter into a cost-sharing arrangement with others. The credit union also employs a process to ensure that it uses the database to comply with the TCPA and does not sell, rent, lease, purchase or use the database in a manner inconsistent with applicable law.

The credit union will also not be liable for calling a member who is on the national do-not-call list if it has obtained the subscriber's prior express permission. Such permission must be evidenced by a signed, written agreement between the subscriber and the credit union in which the subscriber agrees to be contacted by the credit union and includes the telephone number to which the calls may be placed. Liability for calling a member who is on the national do-not-call list can also be avoided where the telemarketer making the call has a personal relationship with the recipient of the call.

MORE INFORMATION: Because the definition of a telephone solicitation under section 64.1200(f)(15) expressly excludes calls to any person with whom the credit union has an established business relationship, the TCPA regulations permit calling a person on the national do-not-call registry if the credit union has an established business relationship with the called person and that person has not requested being placed on the credit union's company-specific do-not-call list.

Hang-Ups and Abandoned Calls

Credit unions may not disconnect an unanswered telemarketing call prior to at least fifteen seconds or four rings, or abandon more than three percent of all telemarketing calls that are answered by a live person, as measured over a thirty-day period for a single calling campaign. A call is considered abandoned if it is not connected to a live sales representative within two seconds of the called person's completed greeting. When a live representative is not available to speak with the person answering the call, the rule requires certain disclosures to be provided including an opt-out message.

Robocall-specific Requirements

The TCPA rules also have certain requirements that apply to all artificial or prerecorded voice telephone messages. Those requirements include the following:

› The first part of the message must adequately identify the person (e.g., "the business, individual, or other entity") behind the call.
› The telephone number of the person initiating the call is clearly identified. The number cannot be a 900 number or any other number that might result in a charge that is greater than local or long distance charges. If the robocall is made to residential subscribers, then "number must permit any individual to make a do-not-call request during regular business hours for the duration of the telemarketing campaign . . . ."
› Advertising or telemarketing robocalls to residential lines or cell phones require "an automated, interactive voice- and/or key press-activated opt-out mechanism for the called person to make a do-not-call request . . . ." If a voicemail is left for a called person, then the "message must also provide a toll free number that enables the called person to call back at a later time and connect

directly to the automated, interactive voice- and/or key press-activated opt-out mechanism and automatically record the called person's number to the seller's do-not-call list."

THE FTC'S TELEMARKETING SALES RULE

The TCPA is not the only federal consideration for making calls to members. The Federal Trade Commission (FTC) has its own telemarketing rule – the Telemarketing Sales Rule (TSR) which applies to state-chartered credit unions and third parties calling on behalf of federally chartered credit unions. The TSR implements the Telemarketing and Consumer Fraud and Abuse Prevention Act (Act). The TSR and the Act regulate telemarketing, and the TSR defines telemarketing as "a plan, program, or campaign which is conducted to induce the purchase of goods or services or a charitable contribution, by use of one or more telephones and which involves more than one interstate telephone call."

The TSR, among other things:

- Prohibits certain practices that constitute deceptive telemarketing acts or practices (e.g., failing to make certain disclosures before a customer consents to pay for goods or services).
- Prohibits certain practices that constitute abusive telemarketing acts or practices (e.g., a telemarketer using profane or obscene language or dialing any telephone "repeatedly or continuously with intent to annoy, abuse, or harass any person at the called number[.]").
- Requires retention of certain records relating to telemarketing activities for at least 24 months.
- Provides for a national do-not call registry and company-specific do not call list.

The TSR and the TCPA have some similarities in how the rules treat certain situations:

Requirement	TSR	TCPA
Do-not-call registries.	Provides for both national registry and company-specific registry. Can call a person on the national do-not-call registry if the credit union has an established business relationship with the called person and that person has not requested being placed on the credit union's company-specific do-not-call list. Can also call a person on the national do-not call registry if the credit union has obtained the express agreement, in writing, from the person receiving the call.	Provides for both national registry and company-specific registry. Can call a person on the national do-not-call registry if the credit union has an established business relationship with the called person and that person has not requested being placed on the credit union's company-specific do-not-call list. Can also call a person on the national do-not-call registry if the credit union has obtained the subscriber's prior express permission or the telemarketer making the call has a personal relationship with the subscriber and the subscriber is not on the company-specific do-not-call list.
Calling restrictions.	Prohibits credit unions from making any outbound calls to persons before 8 a.m. or after 9 p.m. (local time at the called person's location).	Prohibits credit unions from initiating any telephone solicitation to persons before 8 a.m. or after 9 p.m. (local time at the called person's location). Pay attention to what is expressly excluded from the definition of a telephone solicitation (e.g., prior express permission or established business relationship).

Requirement	TSR	TCPA
Prerecorded messages.	Prohibits credit unions from making any telemarketing call that delivers a prerecorded message unless two conditions are satisfied. First, the called person's consent must be obtained. The consent must (1) be obtained after the credit union has provided a clear and conspicuous disclosure that the consent is to receive prerecorded messages from the credit union; (2) not be obtained as a condition of purchasing a good or service; (3) show the called person wants to receive prerecorded messages from the credit union; (4) be in writing; (5) include the called person's telephone number; and (6) be signed (electronic or digital signatures suffice) by the called person. Second, the rule requires the call must (1) ring for either fifteen seconds or four rings before disconnecting an unanswered call; (2); the prerecorded message is played within two seconds of the called person completing their greeting; (3) the prerecorded message discloses the identity of the caller, the purpose of the message is to sell goods or services, the nature of the goods and services, if the call is a prize promotion where a purchase will not increase the odds of winning, that no purchase is necessary, and the message provides an interactive opt-out mechanism where the called person can submit a do-not-call request.	Prohibits credit unions from making any telemarketing calls without obtaining the prior express written consent to make the calls. The TCPA has requirements that are not solely directed at prerecorded calls but would apply to such calls. For example, the TCPA regulations prohibit disconnecting any telemarketing call, not just one delivering a prerecorded message, before the call rings for either fifteen seconds or four rings. The TCPA, just like the TSR, requires an interactive opt-out for all artificial or prerecorded voice telephone messages.

This comparison only looks at a few of the TSR's requirements because federal credit unions are generally outside the scope of the FTC's jurisdiction. Neither the Act nor the TSR apply to conduct that is outside of the jurisdiction of the FTC Act. However, state-chartered credit unions are subject to the FTC's jurisdiction and the TSR. If a federal credit union used a third-party vendor for telemarketing and the vendor fell under the FTC's jurisdiction, the third-party vendor would have to comply with the Act and the TSR. If the TSR applies, the credit union will want to closely examine each of the substantive requirements set forth in the TSR.

RESEARCH TIP: The FTC's website also has numerous resources for telemarketers. While some of these requirements may not apply to federal credit unions, it may be a useful resource for researching vendor compliance obligations and understanding other third-party risks. Credit unions can also sign up to receive the National Do-Not Call Registry here.

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