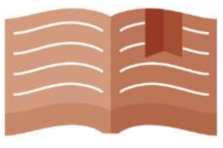
NAFCU COMPLIANCE MONITOR
A Member Service of the National Association of Federally-Insured Credit Unions | nafcu.org
May 2019

Worth Noting 1
Interest Rates Are A'Changin': Interest Rate and Liquidity Risk Management 2
Defining Applications for Online Mortgage Lending 8
News Snippets 12
Compliance Forum 14
NAFCU Education 16



Worth Noting

Material Loss Review Highlights Potential Adjustments to NCUA Examinations. The National Credit Union Administration's Office of Inspector General (OIG) recently published a material loss review (MLR) on losses relating to three credit union failures. The OIG determined the reasons the credit unions failed were due to such contributing factors as having: significant concentrations in taxi medallion loans; unsafe and unsound lending practices, in particular inadequate loan underwriting and monitoring of taxi medallion loans; and weak board and management oversight and inadequate risk management practices, including being unresponsive to repeated issues raised by examiners.

In the MLR, the OIG made two observations and three recommendations to NCUA that are broader than taxi medallion lending. Found towards the end of the report, they likely have implications for how NCUA may act in the future. The OIG observed that examiners were not comfortable taking more forceful action after repeated Documents of Resolution (DORs) or other safety and soundness concerns. In an MLR, the OIG makes recommendations but also shares NCUA management's response to that recommendation:

- Recommendation #1 – Introduce Thresholds for Risk Concentrations. The agency will consider setting thresholds "as part of a process that will be in place by December 31, 2020."
- Recommendation #2 – Revise Examination Quality Control Procedures. By December 31, 2020, an enhanced quality assurance program will include a "more robust" review of exam reports prior to releasing the reports to credit unions.
- Recommendation #3 – Update Annual Exam Scope to Include Lending Procedures. By January 31, 2020, the agency plans to update its internal instructions on examination scope to make sure there is an "emphasis on reviewing credit union underwriting practices" for ensuring borrowers can pay the debit.

This NAFCU blog post provides more specifics on the OIG's recommendations.

National Association of Federally-Insured Credit Unions
3138 10th Street North, Arlington, VA 22201 • Phone: 800.344.5580 • 703.522.4770 • Fax: 703.522.0594
Email: compliance@nafcu.org • Website: nafcu.org • Blog: nafcucomplianceblog.com
Regulatory Compliance Helpline: 877.623.2887, ext. 221, 272, 241, 202, 244, 268, 247, 207

Interest Rates Are A'Changin': Interest Rate and Liquidity Risk Management

One of the National Credit Union Administration's (NCUA) primary areas of supervisory focus for 2019 is to examine for credit unions' management of interest rate and liquidity risk in light of expected future interest rate increases by the Federal Reserve Board (Federal Reserve). *See,* Letter to Credit Unions 19-CU-01. Interest rate risk and its effect on asset liquidity is inherent in the operations of every financial institution and NCUA has provided tools to help credit unions understand the extent of their risk exposure and possibly mitigate it. The agency has also published various liquidity management resources, as well as helpful commentary on the asset concentration risk management failures of three credit unions that were heavily invested in taxi medallion loans. Interest rate and liquidity risk can affect credit unions in a variety of different ways, so in lieu of specific guidelines, NCUA provides more of a high-level framework that can be adjusted as necessary to accommodate the ever-changing marketplace. Since the financial crisis, the agency's treatment of interest rate risk has been somewhat of a moving target. For 2019, NCUA's supervision will specifically focus on the potential effects of rising interest rates on the market value of the credit union's assets, affecting its net worth as well as management's ability to meet liquidity needs in this environment of changing member preferences and new technologies. While NAFCU does not anticipate anything new in the foreseeable future, any Federal Reserve led interest rate changes may stir new guidance or updates to NCUA's existing guidelines.

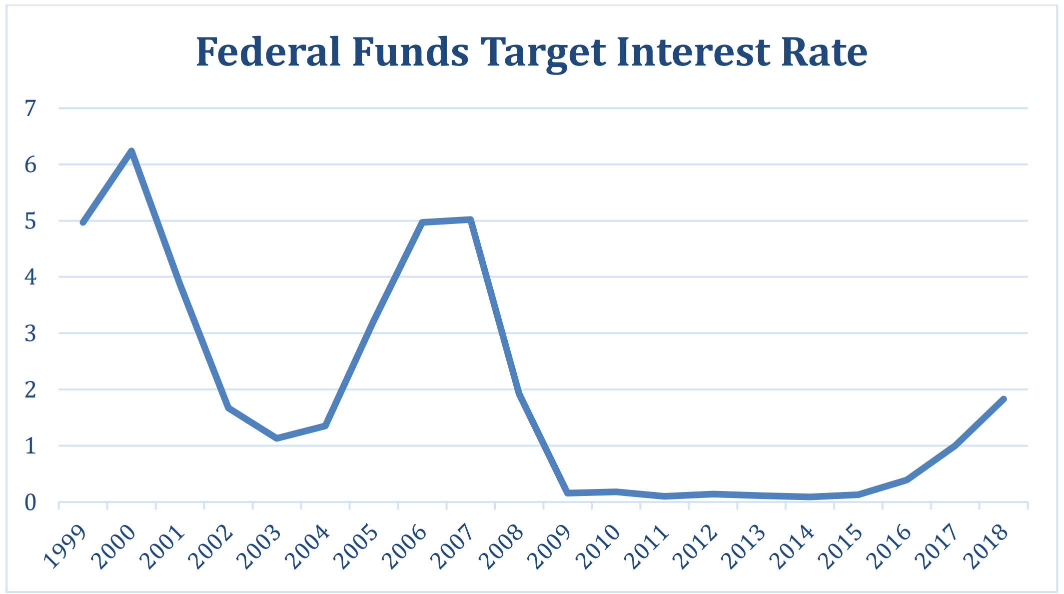
The Effect of Rising Interest Rates on the Market Value of Assets

Interest rate risk encompasses the effect that changes in market interest rates have on a credit union's financial condition. NCUA defines interest rate risk (IRR) as the current and prospective risk to a credit union's capital and earnings arising from movements in interest rates. The NCUA Examiner's Guide provides details on several types of IRR, including repricingrisks, basis risks, yield curve risk, option risk and price risk. From a safety and soundness perspective, repricing risk seems to be the agency's primary focus area based upon the supervisory priorities. Repricing risk arises from the possibility that a credit union's assets and liabilities will reprice at different times or in different amounts due to differing

maturities of assets and changing interest rates of liabilities. When interest rates increase, it alters the value of the balance sheet because liabilities are often repriced much faster than assets. For example, any longer-term fixed rate loans that the credit union currently holds (assets) become less valuable as compared to what is available on the market; while the dividend rates on things such as share accounts and deposits (liabilities) are typically variable-rate meaning they will tend to be repriced according to the market much more quickly. The result of these circumstances can be the reduction of the net worth of the credit union. *See,* NCUA Examiner's Guide, *IRR Types and Sources*.

For these reasons, NCUA believes that when the Federal Reserve eventually increases interest rates, it will put pressure on credit unions to raise deposit rates in order to maintain a deposit account volume large enough to offset any losses. The agency is concerned about the challenge of easily and cheaply increasing a credit union's deposits as the market for these deposits is more competitive than in prior years because of enhanced mobile and internet banking applications and nonbank financial technological developments (Fintech). *See,* Letter to Credit Unions 19-CU-01.

By historical standards, interest rates have been low for some time. As the nation continues to rebound from the 2007 credit crisis, however, interest rates are beginning to rise, as illustrated in this depiction of the Federal Reserve's federal funds target interest rate over the past 20 years:



[Federal Funds Interest Rate Fluctuations since 1999]

The Federal Open Markets Committee (FOMC), a body under the Federal Reserve System, meets at least eight times per year to set monetary policy and determine whether to adjust the federal funds target interest rate. In times of recession, the FOMC is more likely to decrease the interest rate to lower the cost of credit and stimulate demand. For example, interest rates decreased dramatically from 2000-2003 and 2007-2009 in response to periods of recession, as depicted in the graph. Similarly, in an economic boom, the FOMC may increase interest rates to manage inflation and retain the ability to stimulate the market at a future downturn. *See e.g.,* FOMC Statement, December 19, 2018.

Many financial institutions, including credit unions, set lending rates for credit cards and mortgages based upon what is known as a "prime rate." The prime rate is the reference rate used by financial institutions that is typically based upon the federal funds target rate set by the Federal Reserve. Entities like the Wall Street Journal (WSJ) and the British Bankers' Association aggregate this data across the financial spectrum and regularly publish a consensus prime rate. For example, the WSJ "prime rate" is described as the base rate on corporate loans posted by at least 70 percent of the 10 largest U.S.

banks. In recent years, the WSJ prime rate has been the federal funds target rate plus about 3 percent. *See,* FOMC Memo: The Federal Funds Target Rate and Business and Household Borrowing Rates. The FOMC raised the federal funds rate in December 2015 for the first time since 2006, and has periodically, yet cautiously, increased the federal funds rate since this time.

NCUA's IRR Management Requirements and Examination Tools
Reviewing a credit union's interest rate risk exposure and liquidity has long been a part of NCUA's examinations, and has remained a supervisory priority since at least 2012 in anticipation of possible future rate increases. These examination results are reflected in the Liquidity/Asset Liability Management (or L) component of a credit union's CAMEL rating.

The agency requires credit unions with more than $50 million in assets to adopt a written policy on IRR management and implement an effective IRR program. *See,* 12 CFR § 741.3(b)(5). Appendix A to Part 741 provides guidelines on developing an IRR policy and effectively implementing a program based on generally recognized asset liability management best practices. The IRR policy should be appropriately tailored to a credit union's complexity, risk exposure and size. As these factors increase over time, the IRR policies and practices should be implemented with increasing degrees of rigor and diligence to maintain safe and sound operations. An effective IRR policy and program is required to incorporate the following five elements:

1. Board-approved IRR policy;
2. Oversight by the board of directors and implementation by management;
3. Risk measurement systems assessing the IRR sensitivity of earnings and/or asset and liability values;
4. Internal controls to monitor adherence to IRR limits; and
5. Decision making processes that are informed and guided by IRR measures.

Appendix A provides detailed information for each of these elements. In short, credit unions should specifically address IRR in written form as a standalone policy or as part of another policy that varies according to the size and complexity of the credit union's balance sheet. The board is responsible for oversight and annual approval of the policy, which includes determining prudent interest rate limits. Management is responsible for implementing the IRR policy in daily activities and operations, which includes maintaining adequate IRR measurement systems, evaluating IRR risk exposure, allocating sufficient resources for an effective IRR program and establishing an appropriate system of internal controls. As far as risk measurement systems are concerned, the guidance offers illustrative examples of IRR measurement methods available to credit unions, including GAP analysis, income simulation, asset valuation and net economic value. The guide also explains how to set limits for maintaining IRR exposures within prudent levels relative to each IRR measurement method.

In 2017, NCUA adopted more standardized revisions to the procedures used by examiners to monitor, rate and assess IRR. The changes include a revised and simplified IRR Review Procedures Workbook, a formalized Net Economic Value (NEV) Supervisory Test and a revised IRR section in the Online Examiner's Guide. *See,* Letter to Credit Unions 16-CU-08. The IRR Review Procedures Workbook is the tool used by examiners to determine a credit union's overall IRR rating by considering market risk, earnings at risk, stress testing, IRR measurement systems and the credit union's overall risk management and internal control processes.

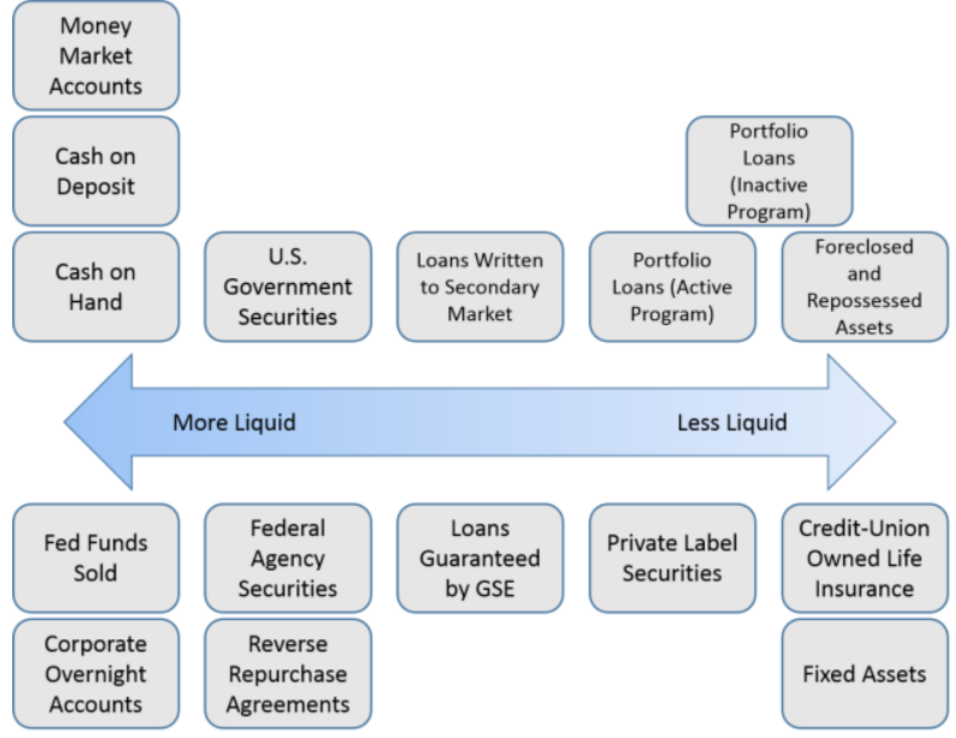
The NEV Supervisory Test is a risk measurement construct. Using both sides of a credit union's individual balance sheet, the test calculates a Net Economic Value ratio and tests the sensitivity of that ratio to scenarios of economic stress. This gives NCUA an idea of the degree to which changes in market interest rates may adversely affect a credit union's economic value. *See,* Guide to Using NCUA's IRR Workbook. The ratio is categorized in one of four categories of risk (low, moderate, high or extreme), and serves as the Overall IRR Supervisory Rating Floor in the market risk section of the IRR workbook. So the ratio serves as a basis from which an examiner will evaluate a credit union's earnings at risk, stress testing, measurement systems and overall risk management processes. *See,* NCUA Revised Interest Rate Supervision Fact Sheet. NAFCU covered the basics of the NEV Supervisory Tool in a Compliance Blog.

NCUA's "Interest Rate Risk" section of the Online Examiner's Guide is a consolidation of the agency's issued IRR materials and provides comprehensive and educational information. It addresses several topics, such as the types and sources of IRR, how IRR relates to other risks, methods and processes to measure IRR, risk management and exam procedures. The Examiner's Guide also provides an exhaustive reference page containing all of NCUA's IRR guidance as well as guidance from the Federal Financial Institutions Examination Council (FFIEC) and other agencies.

Liquidity Risk in a Changing Environment

Liquidity describes a credit union's ability to meet its expected and unexpected cash and collateral obligations without an adverse effect on daily operations. Rising interest rates may affect assets and liabilities due to the immediate repricing of certain liabilities as compared to the inability to reprice assets in the same way due to the nature of the asset or the duration of the maturity. A credit union's liquidity risk is increased when assets cannot be quickly turned into cash to make loans or pay expenses.

NCUA's Examiner's Guide provides three different liquidity categories. Inadequate liquidity occurs in situations where a credit union is unable to meet member withdrawals, make loans, and/or pay expenses. Adequate liquidity is a situation where a credit union has adequate cash or liquid assets on hand to meet current obligations and has a liquidity cushion available to meet unexpected demands without incurring unacceptable losses. Excess liquidity occurs where a credit union has too much cash on hand and may be missing out on potential opportunities to earn even more income. Each asset in the credit union's portfolio carries a different level of liquidity. The guide also provides a helpful graphic of a typical credit union's asset portfolio that is ranked in terms of the level of liquidity for each product:



Assets such as cash, funds in transactional accounts and settlement accounts are among the most liquid because they can be immediately used to pay expenses, whereas loans and fixed assets most often require additional steps. The longer it will take to transform an asset into cash, the less liquid the asset becomes. If a credit union's balance sheet includes significant

amounts of assets considered to be less liquid, this may represent inadequate liquidity or at least a heightened liquidity risk. A credit union can manage this risk by matching expected investment cash flows from its long-term assets against anticipated future funding needs.

Section 741.12 of NCUA's rules and regulations requires credit unions with $50 million or more in assets to craft a contingency funding plan that outlines strategies for addressing liquidity shortfalls in the case of an emergency. The rule specifies that the plan must include a written policy commensurate with a credit union's complexity, risk profile, scope of operations, and a list of contingent liquidity sources. Credit unions with at least $250 million in assets are also required to establish and document access to at least one contingent federal emergency liquidity source, such as NCUA's Central Liquidity Facility or the Federal Reserve's Discount Window. Section 741.12(c) also requires these credit unions to conduct advance planning and periodic testing to ensure that contingent funding sources will be readily available when needed.

Regulatory guidance also indicates that the board of directors is ultimately responsible for the credit union's liquidity risk. The board is required to understand the nature of this risk, and adopt risk management policies to address liquidity and contingency funding needs. In addition, the Interagency Policy Statement on Funding and Liquidity Risk Management requires that the board:

- Establish executive-level lines of authority and responsibility for managing the credit union's liquidity risk;
- Ensure that management properly identifies, measures, monitors, controls and reports on liquidity risk;
- Understands and periodically reviews the credit union's contingency funding plan for handling potential adverse liquidity events; and
- Understands the liquidity risk profiles of important subsidiaries and affiliates as appropriate.

Credit union senior management is responsible for overseeing the development and implementation of the liquidity policy, including appropriate risk measurement and reporting systems, liquid buffers and an adequate internal control infrastructure. Senior management is also required to regularly report on the liquidity risk profile of the credit union to the board. *See,* Interagency Policy Statement on Funding and Liquidity Risk Management. As competitive pressure on the industry from other financial institutions and Fintechs increases, NCUA plans to ensure that credit unions are well positioned and maintain adequate liquidity.

The Taxi Medallion Loan Cases
NCUA's Office of Investigator General recently released the results of its material loss review of three failed federally-insured credit unions: Melrose Credit Union, LOMTO Federal Credit Union and Bay Ridge Federal Credit Union. *See,* MLR Report: OIG-19-06. All three credit unions were based in the New York City area and were heavily invested in Certificates of Public Necessity and Convenience, otherwise known as taxi medallion loans. These transferrable medallions allow an individual or company to operate a taxi and are highly regulated. The limited supply increased demand throughout the 2000s to a point where a medallion sale commanded over $1 million on the open market in 2013. Over this same timeline, New York City experienced a dramatic increase in ride-sharing and ride-hailing technology companies entering the market.

These credit unions failed in part due to their heavy concentrations of over-valued taxi medallion loans coupled with the rise and dominance of ride-sharing applications. While NCUA wants credit unions to take note of how mobile banking applications and non-bank financial technology may affect the balance sheet and future cash flows from a concentration risk perspective, additional lessons can be learned from the failures that go beyond underestimating the potential of new technologies.

In the case of Melrose Credit Union, the agency's review indicated issues with taxi medallion loan monitoring, compliance with regulatory lending limits and risk management of the loan portfolio. The New York state regulator also discovered a lack of Supervisory Committee oversight, strategic planning deficiencies and an overall lack of liquidity. At LOMTO Federal Credit Union, NCUA issued a Letter of Understanding and Agreement (LUA) that explained several weaknesses with loan modifications, strategic planning, liquidity risk, interest rate risk and foreclosure accounting. Regarding Bay Ridge Federal Credit Union, NCUA also issued an LUA detailing a general disregard for adequate concentration and liquidity risk management strategies or practices.

By its own admission, the agency acknowledged that examiners over-looked deficiencies and the credit union's failure to fix issues and respond to Documents of Resolution because the credit unions remained profitable and well capitalized. "The NCUA's enforcement actions were not timely or aggressive enough to limit the loss to the Share Insurance Fund." *See,* MLR Report: OIG-19-06, at 25. Given that these credit union failures cost an estimated $765.5 million to the NCUA Share Insurance Fund, it is all but certain the agency will more heavily scrutinize asset portfolios, interest rate risk and liquidity risk management practices in future examinations.

These additional resources may help when preparing for an examination focused on liquidity risk management:

- NCUA Examiners Guide: Liquidity Resources
- NCUA Letter to Credit Unions 13-CU-10: "Guidance on How to Comply with NCUA Regulation §741.12 Liquidity and Contingency Funding Plans"
- NCUA Letter to Credit Unions 2000-CU-13: "Liquidity and Balance Sheet Risk Management." ♦

Reginald Watson
Regulatory Compliance Counsel

Defining Applications for Online Mortgage Lending

When it comes to regulatory considerations surrounding mortgage loans, a lot depends on the application. Receiving an application can trigger disclosure and reporting obligations under multiple regulatory frameworks — so it is important to understand what meets the definition of an application, when a credit union has received an application, and whether or not the application is complete. When an application is completed at the credit union or tendered in person, these answers are fairly straightforward. However, this is more and more rarely the case. Increasingly, mortgage applications come through online lending platforms and channels where these issues can get muddied. A careful review of the regulatory definitions of application and how they might apply to an online process can clarify these questions.

Applications Under Regulation B

When it comes to applications for new credit, the requirement to provide applicants with notice of action taken under section 1002.9 of Regulation B is triggered by the receipt of an application, which can be either complete or incomplete. The rule defines "application" as "an oral or written request for an extension of credit that is made in accordance with procedures used by a creditor for the type of credit requested." *See*, 12 CFR § 1002.2(f).

The definition also distinguishes a "completed application" as an application for which "a creditor has received all information that the creditor regularly obtains and considers in evaluating applications for the amount and type of credit requested." This can include credit reports, information requested from the applicant and any approvals or reports from government agencies or third parties that are necessary to guarantee, insure or provide security for the credit or collateral. This definition gives credit unions the latitude to establish their own informational requirements and procedures for receiving applications. Comment 2 to this definition indicates it is not just a credit union's written policies and procedures that determine whether an application is made, it is also its practices. If a credit union's written policy requires applications be in writing, but in practice applications are often taken orally as well, under Regulation B that credit union's procedure for purposes of the definition is to accept both written and oral applications. If that credit union only treated a written application as a potential trigger for an adverse action notice, it may be in violation of Regulation B. This regulatory framework aims to create a consistent definition of what is or is not an application from consumer to consumer, while allowing the credit union to set the parameters.

Another piece of this definition that, historically, has received little discussion is that the application is a "request for an extension of credit." When a "request" has been made, it is somewhat straightforward if an application is being taken orally or on paper — the request is made when the application is completed and tendered. However, this can get murky when online application systems come into play. Oftentimes, consumers may log in and partially complete one or several applications. If a consumer took a paper application home, filled out half of it and left it on a desk for three weeks, a credit union would never know it. However, online lending platforms often allow the credit union to view partially completed application forms. If an application is filled out and the information is visible to the credit union, has a request been made? This may depend on whether the consumer took any steps to submit the application to the credit union on their end, like clicking "submit" or "complete" in the system. Without an actual submission step of some sort, it may be impossible to distinguish whether a consumer intends to request an extension of credit from the credit union. Until a request is made, the information does not constitute an application at all under Regulation B's definition.

It is important to distinguish this kind of non-application from an incomplete application with regard to Regulation B. An application under Regulation B can be either complete or incomplete. If the application is not complete, i.e., the credit union has not received all information that it regularly obtains and considers for this product, then it is incomplete. If a consumer submits an application but it is incomplete, section 1002.9 may require a notice of incompleteness and an adverse action notice. Further, the credit union has an obligation under Regulation B to act with reasonable diligence to collect the

information needed to complete the application. However, comment 6 to the definition of application makes it clear this obligation is not triggered until after the application has been received. In other words, if the request has not been made and an application does not yet exist, no application has been received by the credit union and this diligence obligation has not yet been triggered. So while a partially-completed, unsubmitted application form in an online lending platform might be an incomplete application in the typical sense of the word, it is important to understand it may not be an "incomplete application" under the legal meaning of Regulation B.

Applications Under HMDA

When the 2015 Home Mortgage Disclosure Act (HMDA) final rule was published, the Consumer Financial Protection Bureau said many commenters suggested the definition of "application" under Regulation C should align with the definition of either Regulation B or Regulation Z to simplify compliance. The bureau indicated the policy goals of HMDA differ from those of the Truth in Lending Act (TILA) and Regulation Z, but strongly align with the Equal Credit Opportunity Act (ECOA) and Regulation B. After all, one of the purposes of HMDA is to identify possible discriminatory lending patterns and to facilitate the enforcement of the ECOA. *See*, 12 CFR § 1003.1(b)(1)(iii). For that reason, the bureau indicated "it is important for the Regulation C definition of application to be based on the procedures used by the financial institution for the type of credit requested…." *See*, 80 Fed. Reg. 66138. The definition of an "application" in the rule is operationally identical to the definition in Regulation B: "'Application' means an oral or written request for a covered loan that is made in accordance with procedures used by a financial institution for the type of credit requested." *See*, 12 CFR § 1003.2(b)(1). The commentary to the definition goes on to incorporate all of Regulation B's interpretations regarding the definition of application found in Supplement I of that regulation.

This connection between the definition of application in Regulation B and HMDA can be very helpful when a credit union is looking at a unique situation, such as applications through an online platform. Whether and how to report on the application for HMDA purposes can sometimes be clarified by considering how the application was treated for Regulation B purposes. With that said, it is important to note whether HMDA reporting is actually required may depend on several other factors, including whether the credit union meets the definition of a "financial institution" or whether exceptions to reporting exist under the regulation.

HMDA is also tied to Regulation B in other ways. Setting aside HMDA's discussion on loan purchases and preapprovals, neither of which are the focus of this article; it is easy to see how HMDA's "action taken" data point can correspond with Regulation B's requirement to provide notification of an action taken.

<table>
<tr><th>HMDA – Action Taken Codes</th><th>Regulation B – Action Taken Notices</th></tr>
<tr><td>Code 1—Loan Originated</td><td rowspan="2">Section 1002.9(a)(i) requires notification of the creditor's approval of the application, regardless of whether the loan is originated.</td></tr>
<tr><td>Code 2—Application Approved but Not Accepted</td></tr>
<tr><td>Code 3—Application Denied</td><td>Section 1002.9(a)(i) requires notification of the creditor's adverse action taken on the application, and the definition of "adverse action" includes a refusal to grant credit as applied for.</td></tr>
<tr><td>Code 4—Application Withdrawn</td><td>Comment 2 to section 1002.9 states a notification is not required if an application expressly withdraws an application.</td></tr>
<tr><td>Code 5—File Closed For Incompleteness</td><td>Section 1002.9(a)(ii) explicitly requires notifications for applications which are incomplete.</td></tr>
</table>

Comment 6 to subsection 1003.4(a)(8)(i) regarding reporting "action taken" ties HMDA reporting to whether notifications were provided under Regulation B in the context of incomplete applications:

> "A financial institution reports that the file was closed for incompleteness if the financial institution sent a written notice of incompleteness under Regulation B, 12 CFR 1002.9(c)(2), and the applicant did not respond to the request for additional information within the period of time specified in the notice before the applicant satisfies all underwriting or creditworthiness conditions."

However, that is not to say the type of action noticed under Regulation B will dictate what will be reported under HMDA. The same comment goes on to say it is also permissible to report these incomplete applications as denied, rather than closed for incompleteness.

Further, it is important to appreciate that the timeframes for determining the action taken on the application differ for Regulation B and HMDA. The focus under Regulation B is relatively narrow, it is focused on the credit union's decision and providing notice of that decision in the first 30 days. Under HMDA, the credit union is reporting on the ultimate outcome of the loan application, rather than just the credit union's decision. To illustrate this distinction, a credit union could approve an application and provide notice of that approval within 30 days as required by Regulation B. However, a few weeks down the road, the member could back out of the transaction and it may be appropriate to report it as "approved but not accepted" or "withdrawn" for HMDA purposes. *See*, 12 CFR Part 1003, Supp. I, comment 1003.4(a)(8)(i)-13.i.

Because the definition of "application" and the actions taken with regard to an application mirror one another, a credit union can often look to how it treated an application under Regulation B as a starting place for determining how to treat the application for HMDA purposes. If the credit union determined information in an online platform did not constitute an "application" for Regulation B purposes, it is likely the information is also a non-application for HMDA purposes. Conversely, if the information was treated as an "incomplete application" under Regulation B requiring an adverse action notice, the commentary to HMDA indicates it may be appropriate to report it as "denied" or "file closed for incompleteness." This raises the question of what might happen if a credit union's own procedures treat certain information submissions as applications triggering a Regulation B notification but not as HMDA-reportable applications or vice versa. In particular, this may happen when a credit union's practices do not align with its written policies. Remember, it is not only the language of a policy which determines what constitutes an "application" under Regulation B, and therefore HMDA, it is also the credit union's actual practices. As the policy goals of both regulations are aligned and HMDA purposefully ties its definition of application to the definition and commentary in Regulation B, it is possible that varying treatment of the same information submission could raise red flags with examiners.

Applications Under TRID and Regulation Z

As referenced earlier, Regulation Z has its own definition of "application." The timing requirement for providing a Loan Estimate under the TILA/RESPA Integrated Disclosure rules (TRID) is found at paragraph 1026.19(e)(1)(iii). TRID requires the Loan Estimate be provided "not later than the third business day after the creditor receives the consumer's application," as defined by Regulation Z. The definition of application in section 1026.2(a)(3) is bifurcated, with a specific definition that applies regarding the TRID provisions: "an application consists of the submission of 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."

While a lot of discussion and analysis exists regarding the six pieces of information that constitute an "application" under this definition, another piece of the definition is also very significant, the submission. The commentary to this definition explains a submission can be written, in electronic format or a written record of an oral application, making it clear online applications are included in the definition. However, there is little other formal guidance about what constitutes a "submission." In the preamble to the TRID final rule, the bureau did provide some helpful discussion.

Regarding existing relationships with members, the CFPB indicated "merely maintaining such information from a previous transaction or business relationship would not constitute an application for purposes of the definition if the consumer has

not submitted any information or indicated that he or she wishes such information maintained by the creditor to be used for an application." *See*, 78 Fed. Reg. 79768. This seems to indicate it is not a merely question of what the credit union has with regard to the member, but what information the member has indicated he or she wishes to submit to the credit union in connection with an application for credit.

The bureau goes on to specifically address online applications:

> "Additionally, because the definition of application refers to the "submission" of the six items of information that make up the definition, if a consumer starts filling out a mortgage application form online, enters the six pieces of information that constitute the definition of "application," but then saves the mortgage application form to complete at a later time, the consumer has not submitted the items of information." *See*, 78 Fed. Reg. 79768.

This speaks directly to the situation where a credit union may be able to view un-submitted, incomplete application data in a queue. Where a member has only indicated a desire to save the information in the system to complete it another time, they have not submitted the information as required by the definition of "application," and therefore, no application exists to trigger the requirement to provide a Loan Estimate under subsection 1026.19(e)(1)(iii).

More Resources

Online mortgage lending is a big undertaking. While this article addresses a frequently asked question encountered by credit unions doing online mortgage lending, it is only one of many. Credit unions looking for a broader discussion on the topic might find the NAFCU webinar "The Quirks or Online Loan Applications" to be helpful. More discussion on ESIGN issues can be found in "ESIGN Act – Frequently Asked Questions" from the April 2018 issue of NAFCU's *Compliance Monitor*. Those concerned about automatic denials in the online application context might review this NAFCU Compliance Blog post, "HMDA and Auto Denied Loans." Credit unions curious about e-closings might want to check out the CFPB's report "Leveraging Technology to Empower Mortgage Consumers at Closing." Finally, those with more in-depth questions about adverse actions and Regulation B might review NAFCU blog posts "Incomplete Applications and Adverse Actions" and "Joint Applicants and Adverse Action Notices." ♦

Elizabeth M. Young LaBerge
Senior Regulatory Compliance Counsel

Snippets

NCUA Board Meeting. April marked the first full meeting of the National Credit Union Administration (NCUA) Board since the departure of former Chairman Debbie Matz in 2016. Chairman Rodney Hood and Board Members Todd Harper and Mark McWatters all made opening remarks. Chairman Hood said he is committed to ensuring credit unions have the necessary resources to respond to changes in the marketplace and intends to focus on various efforts, including capital reform, cybersecurity enhancements and reducing regulatory burden. Board Member Harper emphasized the importance of bipartisanship and a fair and forward-looking approach to regulation that is effective but not excessive. Board Members Harper and Hood thanked former Chairman McWatters for his work and dedication to the credit union industry. The Board unanimously approved the publication of an advance notice of proposed rulemaking (ANPR) on compensation related to loans to members. This rulemaking seeks to gather feedback regarding credit union compensation programs in an effort to modernize agency regulations to better align with existing industry practices. ♦

Proposed Changes to HMDA Rules. The Consumer Financial Protection Bureau (CFPB) announced the issuance of a notice of proposed rulemaking (NPRM) to raise the coverage thresholds for collecting and reporting data about closed-end mortgage loans and open-end lines of credit under the Home Mortgage Disclosure Act (HMDA) rules. The proposal would provide relief to smaller lenders from HMDA's data reporting requirements and clarify partial exemptions from certain requirements Congress added in the Economic Growth, Regulatory Relief, and Consumer Protection Act. The bureau also issued an advance notice of proposed rulemaking (ANPR) for information on the costs and benefits of reporting certain data points. A Regulatory Alert analysis and summary of each proposal will be available for NAFCU members. ♦

Request for Information on Remittance Rule. The CFPB announced the issuance of a Request for Information (RFI) on its remittance rule. The bureau is looking for information on two aspects of the rule: 1) whether to propose changing the remittance transfer providers the rule covers; and 2) on the expiration of a temporary exception in the rule that allows certain insured institutions to estimate the exchange rate and certain fees that require disclosure when sending remittance transfers. A NAFCU Regulatory Alert is available for members here. If your credit union has had issues in providing remittances due to this rule, your feedback for NAFCU to provide to the bureau would be invaluable. ♦

CDRLF Grant Round Opens June 2. NCUA announced the availability of $2 million in Community Development Revolving Loan Fund (CDRLF) grants for underserved outreach, digital services and security, counselor certification and training. Interest low-income credit unions can submit applications between June 2 and July 20. Those interested in applying for CDRLF grants should register with the federal government's System for Award Management. Grant requirements, application instructions and other information are available in the 2019 Grant Round Application Guidelines. Use NCUA's CyberGrants portal when submitting grant applications. The agency's Office of Credit Union Resources and Expansion will host a WebEx presentation on May 22 to explain the grant process and answer credit unions' questions. ♦

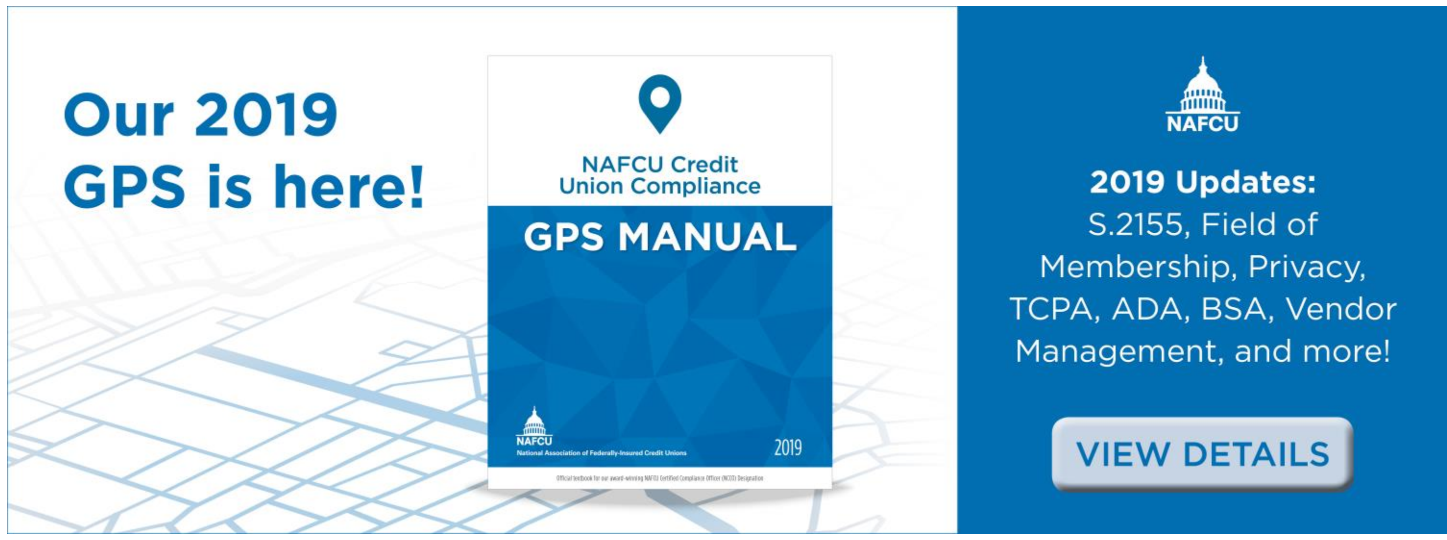
CFPB Symposia Series. CFPB Director Kathleen L. Kraninger announced a symposia series to explore consumer protections. The aim is to stimulate a dialogue with the bureau to assist it in its policy development process, including possible rulemakings. The first topic will be around clarifying the meaning of abusive acts or practices under Section 1031 of Dodd-Frank. Future topics will range from abusive acts or practices, behavioral law and economics, small business loan data collection, disparate impact and the Equal Credit Opportunity Act, cost-benefit analysis and consumer authorized financial data sharing. More details on dates and panelists are to come. ♦

CFPB Director Speech Outlines Bureau's Direction. In a speech at the Bipartisan Policy Center, CFPB Director Kraninger outlined her approach to executing the bureau's mission of consumer protection. She stated a continued commitment to engagement with all stakeholders to be a key part of that approach. Kraninger noted the bureau would use education, regulation and enforcement to execute its mission. ♦

Prohibition Notices. Individuals listed are prohibited from participating in the affairs of any federally insured financial institution**.** On April 30, 2019, NCUA issued three prohibition orders. Phillip H. Darley, II, a former board member of the Panhandle Cooperative Federal Credit Union in Scottsbluff, Nebraska, agreed and consented to the issuance of a prohibition order and agreed to comply with all of its terms to settle and resolve the NCUA Board's claims against him. A former employee of Powerco Federal Credit Union in Atlanta, Georgia, Suzanne Joy Renfroe pleaded guilty to a charge of embezzlement. Julie Ann Turk, a former employee of Allentown Federal Credit Union in Allentown, Pennsylvania, pleaded guilty to charges of bank fraud, embezzlement and money laundering. ♦

Credit Union Conserved. Mid East Tennessee Community Credit Union in Decatur, Tennessee, was placed into conservatorship by NCUA on April 23, 2019. The credit union is a federally insured, state-chartered credit union with 1,855 members and assets of $12,093,966, according to its most recent Call Report. It serves individuals who reside, work, worship, volunteer, have a relative that lives in, or participate in programs to alleviate poverty or distress in Meigs, Rhea or McMinn counties. ♦

Bureau Settlement with Student Loan Servicing Company. The CFPB announced a settlement with Conduent Education Services, LLC (CES), a student loan servicing company for violations of the Consumer Financial Protection Act (CFPA). CES engaged in unfair practices in violation of the CFPA by failing to process principal balance adjustments for loans put into deferment, forbearance or income-based repayment. The company also failed to provide timely payoff information. The order requires CES to pay a $3.9 million fine, make proper adjustments to the principal balances of the loans in question or make restitution. ♦



Compliance Forum

Question – *When does the board need to hold its meeting to elect officers following the annual meeting?*

Answer – Under the federal credit union model bylaws, the board officers must be selected at the board meeting following the annual meeting. The model bylaws explain this board meeting must be held within seven days after the annual meeting:

> "Article VII. Board Officers, Management Officials and Executive Committee
>
> […]
>
> Section 2. Election and term of office. Board officers elected **at the meeting of the board next following the annual meeting of the members, which must be held not later than 7 days after the annual meeting**, hold office for a term of 1 year and until the election and qualification of their respective successors: provided, however, that any person elected to fill a vacancy caused by the death, resignation, or removal of an officer is elected by the board to serve only for the unexpired term of that officer and until a successor is duly elected and qualified." (Emphasis added.) *See*, 12 CFR Part 701, App. A.

As federal credit unions can have different versions of the bylaws, it would be useful to review the credit union's own bylaws to determine whether they contain this provision. If so, then this timeframe would apply.

Question – *If a credit union is required to send a change in terms notice on a credit card account, must a change in terms notice be sent to each co-borrower?*

Answer – When there are multiple borrowers on an account, section 1026.5(d) states "disclosures may be made to any [member] who is primarily liable on the account." The commentary clarifies that, for joint accounts where both parties are liable on the account, disclosures can be sent to either person. As a result, only one change in terms notice is required when there is more than one borrower. However, if there is a borrower and guarantor, the disclosures must be provided to the borrower.

Question – *What documentation does a federal credit union need to obtain to confirm someone is eligible for membership?*

Answer – The National Credit Union Administration (NCUA) does not provide any specific documentation requirements for confirming membership eligibility. Generally, it is up to each federal credit union to decide what information it wants to obtain to confirm eligibility. As allowing persons outside the field of membership to become members is a violation of the Federal Credit Union Act, many federal credit unions, at a minimum, ask for some sort of supporting information. For example, by asking the applicant to check a box indicating they live, work or worship in the community or asking for additional information such as an employer if the applicant indicates she works for an eligible Select Employee Groups (SEG).

Whether to rely on the applicant's indication or ask for supporting documentation will be a determination for the federal credit union to make based on the facts involved. For example, if the credit union has reason to believe the information is not accurate, it might consider asking for documentation from the member, such as a utility bill showing their name and address or a pay stub. Some membership applications also indicate by signing the application, the applicant certifies the

information provided is true and accurate. Federal credit unions may want to consider whether this certification is sufficient to overcome any potential concerns with membership eligibility.

Question – *Are supervisory committee members allowed to attend board meetings?*

Answer – In a past legal opinion letter, the National Credit Union Administration (NCUA) stated members of the supervisory committee at a federal credit union do not have a general right to attend board meetings. While the Supervisory Committee Guide suggests committee members should attend board meetings, there is no legal right for them to do so. It is up to the board of each federal credit union to determine when others, who are not board members, may attend board meetings. In explaining the rationale for deferring to the board, NCUA stated the ability to speak openly and honestly about federal credit union matters is an essential part of the board's duties and the presence of others, including the supervisory committee members, may hinder the board's discussion. The board may decide to permit supervisory committee members to attend meetings, or parts of meetings, but it is not required to do so.

Question – *Is there a regulation that prohibits a loan officer from taking a loan application, disbursing loan proceeds and collecting on the loan?*

Answer – This prohibition comes from the Federal Credit Union Act. Section 1761c(b) states loan officers cannot disburse funds from a loan which they approved. Separation of duties in the lending process is also a common internal control. To prevent fraudulent loans, internal controls principals suggest one employee should not have complete control over the lending process from application to disbursement to collections. While keeping these functions separate may be the simplest way to keep one employee from having control over the entire process, it is not the only way. Others, such as strong oversight over the employee, may also be acceptable. A credit union's internal controls policy will also govern which duties cannot be completed by the same employee or explain what oversight controls are in place. As the National Credit Union Administration (NCUA) expects a credit union to follow its own policies, credit unions may want to carefully review such policies when assigning these job duties.

Question – *Under the recent S.2155 amendments, may a credit union now copy military identification cards as part of its customer identification program?*

Answer – Federal law prohibits credit unions from copying or scanning any federal identification, including military identification cards. *See*, 18 USC § 701. The law does not provide any exceptions for customer identification programs. Section 213 of S.2155 allows credit unions to copy driver's licenses and personal identification cards for accounts opened online and financial services obtained online. This provision preempts only state laws that prohibit copying driver's licenses and other state-issued identification cards; it does not preempt federal laws that prohibit copying federal identification cards. Information from a military identification card can be recorded to meet customer identification program requirements, such as the identification number or expiration date, however, the card itself may not be copied.

NAFCU Education

Webinar: Website and Social Media Compliance
May 14, 2019 | 2:00 p.m. – 3:30 p.m. ET

Webinar: Regulatory Compliance Risk Awareness for Board/Supervisory Committee
Available On-Demand May 15, 2019

Webinar: The Telephone Consumer Protection Act: A Long and Winding Road
On-Demand

Webinar: Vendor Management
On-Demand

Webinar: Using the FFIEC Guidelines and the ACAT to Drive Strategic Technology Planning
On Demand

Conference: BSA Seminar
August 11-14, 2019 | Minneapolis, MN
Register with code BSASAVINGS by 6/14/19 to save $200

Conference: Summer Regulatory Compliance School
August 12-16, 2019 | Minneapolis, MN
Register with code SUMMERSAVINGS by 6/14/19 to save $200

Conference: Regulatory Compliance Seminar
October 1-4, 2019 | Savannah, GA
Register with code SEMINAR19SAVINGS by 8/2/19 to save $200

EDITORIAL STAFF

Publisher/Managing Editor:
Brandy Bruyere, *NCCO*

Senior Editors:
Elizabeth M. Young LaBerge, *NCCO, NCRM, CIPPS/US*
Shari R. Pogach, *NCCO, NCBSO*

Associate Editors:
Jennifer Aguilar, *NCCO, NCBSO*
Reginald Watson, *NCCO*
David Park, *NCCO*
Alma Calcano, *NCCO*
Loran Jackson

This publication is intended to provide general compliance information in regard to the subject(s) covered. It is provided with the intent and understanding that the publisher is not engaged in the act of rendering legal, accounting or any other professional advice. The information provided in this publication is not intended nor should be issued as a substitute for legal advice or other expert opinions and services in specific situations.

Current and prior issues of this NAFCU publication are archived and may be accessed by NAFCU member credit unions at nafcu.org/bsablast, a password protected members only section of the NAFCU website.

Copyright © 2019 National Association of Federally-Insured Credit Unions. All rights reserved. NAFCU does not claim a copyright to government information.

National Association of Federally-Insured Credit Unions
3138 10th Street North, Arlington, VA 22201 • Phone: 800.344.5580 • 703.522.4770 • Fax: 703.522.0594
Email: compliance@nafcu.org • Website: nafcu.org • Blog: nafcucomplianceblog.com
Regulatory Compliance Helpline: 877.623.2887, ext. 221, 272, 241, 202, 244, 268, 247, 207