Regulatory compliance strategies for commercial lenders

Presented by:
Jim Conley and Susan Roemer
Regulatory compliance strategies for commercial lenders

Presented by:
Jim Conley and Susan Roemer
Outline of Today’s Presentation

• General and basic discussion of Laws and Regulations applicable to commercial lending.

• Commercial Lender responsibilities for compliance.

• Personal and organizational cost and consequences of non-compliance.
Outline of Today’s Presentation

Laws and regulations applicable to commercial lending:

- Fair Lending Laws and Regulations
  - Equal Credit Opportunity Act (ECOA)
  - Fair Housing Act (FHA)
- Fair Credit Reporting Act (FCRA)
- Home Mortgage Disclosure Act (HMDA)
- Community Reinvestment Act (CRA)
- Flood Disaster Protection Act (FDPA)
- Interagency Appraisal and Evaluation Guidelines
- Servicemembers Civil Relief Act (SCRA)
- Loans to Insiders (Reg. O)
- Other Laws and Regulations (BSA, OFAC, USA PATRIOT ACT, ADA and many more)
Due to the implementation of Dodd Frank, Fair Lending Laws (ECOA and FHA) are being more rigidly enforced by the CFPB, the Department of Justice and State and Federal Regulatory agencies.

Examination coverage is becoming more comprehensive with more sophisticated methods and analytic techniques being utilized.
Other relative laws that weigh in the process with enforcement actions taken to ensure the accuracy and completeness of monitoring data include:

- FCRA
- HMDA
- CRA

Residential Real Estate “dwelling” secured loans remain a focal point of enforcement of Fair Lending Laws.
Discriminatory acts and practices, disparate treatment and disparate impact all revolve around prohibited basis, as defined by FHA and ECOA as follows:

- **ECOA**: Marital Status, Age, Public Assistance Income, Rights exercised under Consumer Credit Protection Acts (CCPA)
- **ECOA and FHA**: Race, Color, Religion, Sex, National Origin
- **FHA**: Familial Status including Same Sex Marriages by CFPB Policy, Handicap
Fair Lending is more easily said than done. Inadvertent, unintentional – it doesn’t matter.

- Establish prudent policies with specific guidelines addressing fair lending considerations for application, underwriting, servicing and collection practices. Include specific documentation and approval requirements for exceptions. Standardize products. Minimize discretion.

- Ensure Commercial Lending activities and processes are properly and diligently evaluated as part of the organization’s fair lending risk assessment.
• Take applications for all commercial loans — include ECOA rights disclosure and for Ohio, the Ohio Civil Rights Disclosure

• Obtain notice of intent to apply for joint credit from all persons applying for credit and all guarantors

• Be mindful of prohibited basis applicable to various transactions and activities (by the bank, borrowers, appraisers and third Parties) including selling, renting, brokering, appraising, pricing (rates and fees), terms. The discriminatory acts or practices of others may extend to the bank.

• Take applications or formal written requests for modification and extension agreements. Process and underwrite these with the same uniform standards and procedures as a loan application.
EQUAL CREDIT OPPORTUNITY ACT (ECOA)

Adverse Action Notices
(notice of action taken)

Appraisal Notices and Delivery Requirements
ECOA—Adverse Action

• **Adverse Action:** A refusal to grant credit in substantially the terms requested unless creditor makes a counter offer that the applicant accepts. May also apply to requests to renew, extend, increase or modify credit depending on standard policies, procedures and practices.

• Adverse action notices: for businesses with revenue \(\leq\) $1 million, may be given orally if ECOA rights are disclosed at the time of application. However, upon request, a written notice with a statement of reasons must be provided. If the ECOA rights are not given at the time of application, a written notice of adverse action must be provided.

• Adverse action may be given orally for businesses with \(>\$1\) million in revenue. However, if an applicant requests within 60 days, a written statement of reasons must be provided.

• Guarantors aren’t applicants and not entitled to adverse action notice.
ECOA—Appraisal Notice

- Disclosure of right to receive a copy of appraisal/valuation; required for loans secured by 1st lien on a dwelling.

- Creditor must also provide a copy of the appraisal or other written valuation promptly upon completion or 3 business days prior to consummation for a closed-end transaction or account opening for open-end credit – whichever is earlier.

- Deliver to primary applicant.

- Primary applicant may waive early delivery requirement.
FCRA & FACTA

FAIR CREDIT REPORTING ACT (FCRA)

FAIR AND ACCURATE CREDIT TRANSACTIONS ACT (FACTA)
• **Credit reports are consumer reports** - even if pulled for business purpose credit.

• Only pull credit report for **valid business purpose**. Remains a consumer report subject to all the consumer protections.

• Guarantors are not applicants and not entitled to FCRA adverse action disclosure.

• Individual business loan applicants denied on the basis of credit report information must be given an FCRA adverse action notice.

• Provide notice of action taken to credit applicant. **Never** provide the guarantors credit score to the applicant.

• If credit information is furnished to credit reporting agency, only report on guarantors when creditor has exhausted efforts to collect from borrowers and demanded payment from guarantors.
• Commercial borrowers (entities, individuals, guarantors) are subject to identity theft.

• Be alert to identity theft and know the red flags.

• Ensure the Commercial Lending Department is included in the bank’s identity theft (red flags) risk assessment.

• Know your borrowers and guarantors.
HOME MORTAGE DISCLOSURE ACT (HMDA)
CFPB REG. C
- Gathering and reporting of certain data for loans secured by a dwelling for the purpose of purchase, refinance or home improvement.

- Home improvement is any loan secured or not secured by a dwelling to be used, at least in part, for repairing, rehabilitating, remodeling, or improving a dwelling or the real property on which the dwelling is located.

- A home improvement loan may include a loan made outside a banks residential mortgage area.

- Home purchase loan is any loan secured by and made for the purpose of purchasing a dwelling.

- Refinancing is any dwelling secured loan that replaces and satisfies another dwelling-secured loan to the same borrower.
• **Mixed-use property** – for example, a building containing apartment units and retail space.

• **Farm loan** – a loan to purchase property used primarily for agricultural purposes is not a home purchase loan even if the property includes a dwelling.
COMMUNITY REINVESTMENT ACT (REG. BB)
CRA recognizes many different types of loans that have a positive impact on low- or moderate-income (LMI) areas or support community development for those areas.

Commercial loans are very important to the institution’s CRA program by redeveloping or improving property in LMI areas, and by providing jobs, services and other economic opportunities for the LMI markets in the institution's CRA assessment area.

Institutions with $1.221 billion or more in assets are required to collect and report certain data for small business/small farm loans annually. The data is reported in accordance with Call Report instructions.

All institutions are subject to CRA performance evaluations.
INTERAGENCY APPRAISAL AND EVALUATION GUIDELINES
Appraisal programs should include:

1. Independence of persons ordering, performing, reviewing appraisals & evaluations
2. Selection criteria and procedures
3. Compliance with regulations and supervisory guidance
4. Maintain criteria for the content and use of evaluations consistent with safe banking practices
5. Timely receipt & review of appraisal or evaluation report to facilitate credit decisions
6. Criteria for whether an existing appraisal or evaluation may be used to support subsequent transactions.
7. Internal controls that promote compliance with the program standards
8. Criteria for monitoring collateral values
9. Criteria for valuations in transactions not otherwise covered by applicable appraisal regulations
• Examiners review an appraisal or evaluation to determine whether the methods, assumptions and value conclusions are “reasonable.”

• Applies to all real estate transactions – consumer and commercial.

• Outsourced arrangements to third parties.

• Minimum Requirements for Appraisal Management Companies (DFA- section 1124 of Title XI); Agencies issued final rule April 30, 2015 (effective 60 days after publication in Federal Register).
Bank may use an internal evaluation supported by internal analysis, real estate tax records, prior appraisals, and inspection and condition reports for the following (New appraisal not required):

- Transactions of $250K or less.
- Commercial (business loan) transactions $1MM or less
- Extension/renewal of existing credit with no change in market conditions affecting property, no significant change in property, no new money (except closing costs).
- Rate and Payment modifications, short term extensions, terms or amortization with no new money, no change in borrower/guarantor obligation, no changes in collateral protection.
FLOOD DISASTER PROTECTION ACT (FDPA)
• The flood rules apply to loans secured by a structure and include collateral held as an abundance of caution. The rule also applies to contents of a building held as collateral.

• Applies anytime a loan is made, refinanced or increased. The FDPA also applies when a lender extends or renews the term of a loan through a modification or extension.

• Biggert Waters increased the maximum coverage available for non-condominium residential buildings designed for use for five or more families from $250,000 to $500,000.

• Insurance required = the lesser of the outstanding principal balance, maximum available under the NFIP, or the insurable value of the building (generally the replacement cost value).
• Insurance required for buildings in the course of construction.

• Don’t forget “content” insurance for loans secured by inventory, business assets etc.

• Detached residential structure provision within the 2014 Homeowner Flood Insurance Affordability Act (HFIAA) became effective March 21, 2014.

• Force placement procedures; tracking, monitoring, notification templates.
SERVICEMEMBERS CIVIL RELIEF ACT (SCRA)
Limitations and protections to Servicemembers and their dependents under the SCRA.

- Six percent (6%) interest rate cap.
- Foreclosures and other default judgments.
- Prohibitions:
  - Adverse credit reporting
  - Credit denial, restrictions, modified terms, due to exercise of SCRA rights
- Limits on repossessions and termination of leases or installment contracts.
- Protects Servicemembers and dependents from evictions for non-payment of leases or obligations (special tenant rights).
- Limitations on fines and penalties such as late payment fees.
- [https://www.dmdc.osd.mil/appj/scra/single_record.xhtml](https://www.dmdc.osd.mil/appj/scra/single_record.xhtml)
Insider Credit—REG. O

LOANS TO INSIDERS
FRB REG. O
Insider Credit—REG. O

- Can make loans to Directors and their related interests on substantially the same terms as available to other borrowers (avoid preferential treatment)—subject to limits per individual and in aggregate.

- There are special limitations on credit to Executive Officers
  - Required Prior Board approval, required financial information, and required demand clause

- Reporting requirements (quarterly CALL report).

- DON’T MESS WITH REG. O — potentially severe penalties range from $7500 per person per day up to $1.1 million per day and regulatory actions or a DOJ investigation can be lengthy, disruptive, costly and draining on resources.
Other Laws and Regulations

BANK SECRECY ACT (BSA)
OFFICE OF FOREIGN ASSET CONTROL (OFAC)
USA PATRIOT ACT
AMERICANS WITH DISABILITIES ACT (ADA)
Commercial Lenders must be aware of relative risks associated with transactions including:

- **Environmental Risks**—EPA/CERCLA/SUPERFUND
- **Servicemembers Civil Relief Act** (SCRA)
- **Americans with Disabilities Act** (ADA)
- **State and Federal Consumer Protection Laws** including discriminatory acts and practices
- **Unfair and Deceptive Acts or Practices**
- **Abusive Behavior**—Harassment, Predatory Acts
- **Harboring and Immigration Laws**
- **Tax Evasion**
All banks are required to establish an effective Compliance Management System. The following should be included in your program:

- Train, Train, Train
- Policies and Procedures
- Application Process
- Appraisal Process
- Closing Process
- Post-Closing Quality Control
Complete the process — Get feedback

Make sure your policies, procedures, checklists and commercial loan portfolio (new production) are being independently reviewed and tested for compliance by internal compliance audits and loan reviews.

Reports should go to the audit committee or board

Ensure Board Awareness of Laws and Regs.

Follow up on any needed corrective action
Questions?
Thank you!

Jim Conley, Principal
jconley@cshco.com
513.241.3111

Susan Roemer, Manager
sroemer@cshco.com
513.241.3111