



# REGULATORY COMPLIANCE ROUNDTABLE

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# Bank Regulatory Compliance Roundtable

March 14, 2024

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## | The 2024 compliance outlook

ON JANUARY 18, 2024

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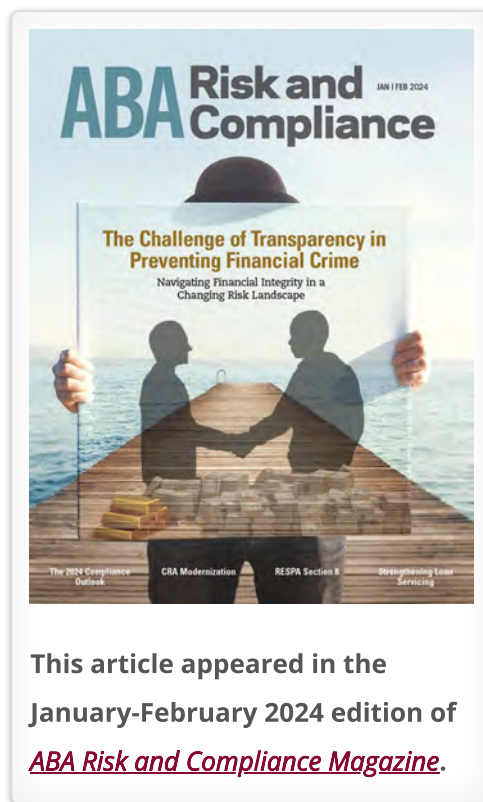
by Carl Pry, CRCM, CRP

Trying to predict what will happen in the banking compliance world is always a fool's errand. You never know for sure what's going to happen—could anyone have predicted the failures of three larger banks in 2023 and the resulting attention on liquidity and FDIC insurance, for example? Life in general is unpredictable, but fortunately in the compliance world we have a few fairly reliable indicators we can monitor to take an educated guess at upcoming events, such as regulatory agendas and announcements. As well, the agencies these days (to their credit) are more transparent in what they see as important (artificial intelligence and algorithms, cryptocurrency, fair lending, and fees, to name but a few), so we can safely count on additional guidance, commentary and perhaps new rules and regulations to be issued in these areas.

We do know there are several regulations slated to be issued in various forms in 2024, and we should start to plan now for how these rules will impact bank operations. Let's peer into the crystal ball and see what we have to look forward to in 2024.

### Hurry up and wait

We are currently in a time where a few rules and issues are uncertain because of ongoing litigation. We're all awaiting the U.S. Supreme Court's ruling on the funding structure of the Consumer Financial Protection Bureau (CFPB), which is expected sometime in the summer. More relevant to our attention is a potential delay, until after the Court's ruling, of the requirements of the CFPB's Small Business Lending Data Collection final rule in Regulation B (from Dodd-Frank Act Section 1071), and whether there will be any changes to the rule. At this point it is unknown



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when and what will happen, but it is highly unlikely that the rule will go away entirely. The implementation date has been pushed back (although we don't yet know how far), and/or some data fields required by the rule may change, but banks would be wise to use any additional time to continue to plan how they will comply, both from an operational and technological perspective, as well as dealing with the cultural changes the rule will unleash. Any extra time can also be used to evaluate what the first year of data shows.

Similarly, there is uncertainty surrounding the CFPB's 2022 revisions to its Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) examination procedures, which assert that the CFPB can use "unfairness" to prohibit discrimination across all bank operations. Depending on how ongoing litigation on this issue turns out, banks may have to start planning for examinations where their decision-making processes outside of lending are evaluated to consider who is impacted (or excluded altogether). There are additional issues to be worked out here, including how "discrimination" will be defined and how the standard will be enforced (among many others). But for now, we're in a holding pattern.

### **Preparing for new final rules already issued**

Primary in this category is the long-awaited update to Community Reinvestment Act (CRA) regulations issued this past October. The new rules mean big changes for banks classified as large banks (meaning \$2 billion or more in assets), while intermediate-sized banks (from \$600 million to less than \$2 billion) will see more moderate changes to their CRA compliance efforts. Small banks (less than \$600 million) would see practically no changes at all unless they opt in to some of the new requirements. While the rule's effective date is likely to be in early or mid-2024, compliance will be required beginning in 2026, with data reporting requirements (for those banks that fall under those requirements) at the beginning of 2027. That's not far away when considering the magnitude of the changes the new regulation imposes. There will likely be more information coming from the agencies to help us figure out all the intricacies of the new rule, but affected banks should already be planning for the changes.

### **Awaiting new rules**

While there were relatively few new final rules issued in 2023 (again looking at you, CRA), there were a number of proposals and pre-proposal activities issued where further advancement is expected in 2024. This means our change management processes must be on full alert to make sure we are aware of what changes and when, and to determine the applicability to the bank of any new rules or guidance. Among the regulations and guidance on which we should see movement in 2024:

**Open banking rule.** In October 2023 the CFPB issued a proposed rule under Dodd-Frank Act Section 1033 to facilitate what it calls “open banking,” which would give consumers more control over their financial data, and would offer protections against companies misusing consumer data. Some form of a final regulation is expected in 2024. The rule will ensure consumers can obtain their personal financial data from their bank (likely at no cost—see the later discussion on fees in general), as well as providing consumers with a legal right to grant third parties access to information associated with their credit card, checking, prepaid, and digital wallet accounts.

There are a number of issues that must be addressed in a final regulation, including the precise definition of the types of entities and information covered, how covered data will be provided to consumers and third parties, how shared data can be used, and whether there are any meaningful exceptions. But in any case, banks will need all the time they can get to determine what they must make available and how, as well as what disclosure of information will mean to consumers. For example, will customers question why you have the data you are providing to them, and what you’ve been doing with it? And will customers use the data to take their deposits elsewhere?

**Fair Credit Reporting Act changes.** In September 2023, the CFPB announced it will start a rulemaking process to significantly expand the reach of the Fair Credit Reporting Act (FCRA). This has been long anticipated; it has been clear from CFPB pronouncements over the last few years that the bureau feels strongly that increased regulation is needed in this area, and we will soon see what they have in mind. One issue likely to become part of the revised regulation is a mandate that consumer reporting agencies remove medical bills from credit reports. While current rules allow banks to obtain and use medical information in certain circumstances, new amendments are likely

to entirely prohibit creditors from considering medical bills for underwriting decisions, among other things.

Even more expansive changes are in store. The bureau is considering broadening the definition of “consumer reporting agency” to encompass data brokers and “consumer report” to include consumer-identifying information (such as name, address, social security number, etc.), which could ultimately limit the disclosure or sale of this data without a permissible purpose. At the heart of this is the definition of so-called “data brokers”—meaning firms that sell or share reports containing consumers’ payment history, income, criminal records, and possibly consumer-identifying information—as consumer reporting agencies themselves. Other possibilities include strengthening the process to obtain a consumer’s written permission to obtain a credit report; narrowing the definition of “legitimate business need,” the FCRA’s catch-all permissible purpose to use consumer report information; and determining that certain types of targeted marketing activities that do not directly share information with a third party are subject to the FCRA, and that marketing is not a permissible purpose for using consumer report information.

While we’re not likely to see final regulations in 2024, we can expect to see a proposed rule. We’ll then have a clearer idea of what the new requirements will mean, but until then it’s a good idea to do an inventory of the types of information (including consumer-identifying information) received from third parties (credit bureaus or otherwise), and nail down exactly what’s done with that data. That way, it will be easier to determine what new restrictions may apply to those practices.

**Customer due diligence rules under the Bank Secrecy Act.** FinCEN’s rulemaking process under the Anti-Money Laundering Improvement Act of 2020, including the Corporate Transparency Act (CTA), has been a slow-moving story. At first, we all were excited about the possibility that the CDD rule (that became effective in 2018), requiring financial institutions to determine any beneficial owners and control persons of business customers, might somehow go away, to be replaced by a process where businesses report their information directly to the federal government. But alas, that doesn’t seem to be in the cards; rather, it appears we’ll have some sort of parallel process where businesses are required to report their information to a government database, and financial



institutions will still need to collect information from their customers to satisfy CDD rule obligations. In the future, banks will have some form of access to that database to compare against the information they've collected.

The first piece of this puzzle was finalized in late 2022. A final rule was issued pursuant to the CTA establishing the beneficial owner reporting requirement for "reporting companies." The rule became effective on Jan. 1, 2024. Companies created in 2024 have 90 days after creation to submit their beneficial owner Information, or BOI, report to FinCEN. Companies created in 2025 or after have 30 days after creation to submit their BOI report to FinCEN. For companies created before 2024, reporting is required by Jan. 1, 2025. Commercial customers may not be aware of these new requirements, and those that are aware of the requirements may need some assistance understanding what the requirements are and how to submit the required form.

We're now waiting for the other shoe to drop. We have the final reporting rule but the CTA also requires FinCEN to revise the CDD rule. We're waiting for FinCEN to propose revisions to the CDD rule to explain the interplay between the reporting rule requirement and how banks would utilize this information to comply with their CDD responsibilities under the BSA. FinCEN has stated that proposed regulations are forthcoming, and sometime in 2024 is the target date for their issuance.

**Debit card interchange fees.** In October 2023, the Federal Reserve issued a proposal to lower the maximum interchange fee that a large debit card issuer (with at least \$10 billion in assets) can receive for a debit card transaction. The rule would also establish a regular process for updating the maximum fee amount every other year going forward. This is the so-called "Durbin Amendment" that was part of the Dodd-Frank Act, and is now the Federal Reserve's Regulation II.

The Fed says costs incurred by these large debit card issuers have declined dramatically since the rule's introduction in 2011, yet the fee cap has remained the same. The proposal would lower the cap from its current rate of 21 cents and .05% of the transaction, plus a one-cent fraud prevention adjustment, to 14.4 cents and .04% per transaction, plus a 1.3 cents fraud prevention adjustment. If finalized the change would be effective June 30, 2025. Just as when the original rule was put in place,

feedback from the banking industry has been almost universally negative, but yet the rule was put in place anyway. Large debit card issuers should be on the alert to determine whether fee income in this area will be cut even more.

**Automated Valuation Model (AVM) rules.** Originally mandated by the Dodd-Frank Act, in June 2023 the agencies issued a joint proposal to implement quality control standards concerning AVMs used by mortgage originators and secondary market issuers. The rules will require institutions that engage in certain mortgage-related credit decisions or make securitization determinations to adopt quality control standards (meaning policies, practices, procedures, and controls) to ensure a high level of confidence that estimates produced by AVMs are fair and nondiscriminatory. Lenders will need to protect against data manipulation and avoid conflicts of interest by conducting random sample testing and reviews, as well as ensuring compliance with applicable nondiscrimination laws (such as the Equal Credit Opportunity Act and the Fair Housing Act). This has a strong relation to appraisal bias, but the precise requirement of how to do this (for example, whether this is a direct responsibility of the lender or can be done by the AVM provider or third-party provider) will ideally be delineated in the final regulation, which is expected in 2024.

**Reconsideration of value guidance.** Keeping with the property valuation theme, in June 2023 the agencies issued proposed interagency guidance relating to reconsideration of value, or ROV, requests for residential real estate valuations. The proposed guidance advises institutions on policies that would afford consumers an opportunity to introduce evidence that was not previously considered in the original appraisal, and addresses deficiencies in such valuations due to errors or omissions, valuation methods, assumptions, or other factors. Of course, bias on the part of the appraiser is a primary concern here, but it is not the only reason an ROV may be requested. In addition, the CFPB has been quite public about its position that consumers should have the ability to question the appraised value of the property.

At this point it is clear that the agencies expect banks to have some sort of ROV process to address concerns on the part of the borrower. But final guidance will ideally provide clearer direction on how ROV requests overlap with appraisal independence requirements, since it is a basic tenet of

appraisal compliance that the lending function and appraisal function be independent. How can an ROV request be handled without sacrificing that independence? The proposed guidance provides examples of ROV policies, procedures, control systems, and complaint processes to address deficient valuations; once final guidance is issued, we'll know more fully how these systems are expected to function.

It is also worthy of mention that in early 2023, HUD Secretary Marcia Fudge announced that HUD is creating a process that people seeking FHA financing can use to request a review of their appraisal if they believe the results may have been affected by racial bias. According to the announcement, this effort "represents the first step to solidify the processes that lenders must follow when a borrower requests a review if concerns arise around unlawful discrimination in residential property valuations." In addition to providing an example of what this process may look like, a companion proposal provided guidance for obtaining a second appraisal when material deficiencies are documented and the appraiser is unwilling to resolve them.

**Credit card penalty fees.** In February 2023, the CFPB issued a proposal under Regulation Z to ensure that late fees charged on credit cards are "reasonable and proportional" to the late payment as required under the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act). Under the proposal, the safe harbor dollar amount for late fees (currently \$30) would be lowered to \$8 for any missed payment, and the higher safe harbor dollar amount for late fees for subsequent violations of the same type (currently \$41) would be eliminated. The automatic annual inflation adjustment for the immunity provision amount would also be eliminated. As well, the maximum late fee amount would be capped at 25 percent of the required minimum payment (the maximum is currently 100 percent).

As expected, these proposed limits were met with pushback from the industry, so it will be interesting to see what the limits eventually are when the final rule is issued, which is expected sometime in 2024. But that might not be the end of additional credit card changes. That same proposal requested comment on "whether the proposed changes should apply to all credit card penalty fees, whether the immunity provision should be eliminated altogether, whether consumers

should be granted a 15-day courtesy period, after the due date, before late fees can be assessed, and whether issuers should be required to offer autopay in order to make use of the immunity provision." We'll have to see what else the bureau has in mind that will impact the credit card market.

**FDIC official sign and advertising statement.** In late 2022, the FDIC issued a proposed rule "to modernize the use of the FDIC official sign and advertising statement," reflecting increased use of "digital channels, such as bank websites and mobile applications, through which depositors are increasingly handling their banking needs." The changes will also reflect the FDIC's desire to more clearly differentiate between products that are insured from those that are uninsured. A final regulation is expected to clarify expectations around digital displays of the FDIC advertising statement on websites and mobile apps, including clear notifications on relevant pages where uninsured products are offered.

**Mortgage servicing rules.** In June 2023, CFPB Director Chopra stated in a blog post that the bureau is considering whether to streamline its mortgage servicing rules, located principally in the Real Estate Settlement Procedures Act (RESPA). This furthers an effort by the bureau, begun in September 2022, where it requested input from the public on mortgage refinance and forbearance standards and sought feedback on ways to reduce risks for borrowers who experience disruptions in their ability to make mortgage payments. Commenters referred to the "paperwork treadmill," along with other difficulties encountered when trying to secure assistance when in trouble. The bureau stated it "will propose streamlining only if it would promote greater agility on the part of mortgage servicers in responding to future economic shocks while also continuing to ensure they meet their obligations for assisting borrowers promptly and fairly." Any proposed rule is likely to address servicing fees, credit reporting, and LEP borrowers, among other issues. It will be interesting to see whether it chooses to act by making the process a bit easier for all involved.

**Possible changes to construction loan disclosures.** Early in 2023, the CFPB sought public comment on possible alternative mortgage disclosures for construction loans, stating a consumer's understanding of construction loans would be improved if disclosures were more specifically

tailored to these types of transactions. This was an acknowledgment that the TILA-RESPA Integrated Disclosure (TRID) rules within Regulation Z are somewhat of a square peg in a round hole when it comes to construction loans. Those banks who make construction loans would surely agree, and would welcome any sort of clarity and/or customization of the forms to address the many peculiarities in construction lending. While nothing seems imminent, it would be a welcome revision to the TRID rules should it happen.

### **Areas of continued regulatory focus**

There are several issues within the banking industry that continue to generate intense interest from the agencies, and there is no reason to suspect this will lessen in 2024. Within this category are the following topics:

**Continued intense focus on fair lending issues.** While certainly not a new development in compliance circles, certain specific issues continue to have the agencies' (as well as the Department of Justice's) full attention now, and will continue into the foreseeable future.

**Appraisal bias.** As referenced above through impending AVM regulations and ROV guidance, how properties are valued continues to be a concern to be addressed in various ways in the coming months and years. The Property Appraisal and Valuation Equity (PAVE) task force issued its Action Plan in March 2022, and it included a multitude of recommendations that would impact both the appraisal and mortgage lending industries. Thus far we've not seen much action in the way of new rules and regulations, but that may change in 2024.

Within the past two years, the banking agencies have sent two letters to the Appraisal Foundation (the body that oversees appraisers), urging it to further revise its Ethics Rule applicable to appraisers to include a detailed and explicit statement of federal prohibitions against discrimination under FHA and ECOA. It is the agencies' opinion that the first attempt to make appraisers more aware did not go far enough. This may be one of several additional requirements appraisers must eventually follow, such as enhanced anti-bias training and efforts to better diversify the appraisal profession.

Any such changes must be monitored by lenders to ensure the appraisers they engage meet any new requirements imposed by this self-regulatory body.

We can also expect more commentary, guidance, and/or recommendations, if not proposed regulation, around detecting and preventing bias in appraisals that lenders use. The CFPB has opined several times that a lender's use of a biased appraisal would constitute a potential violation of Regulation B; HUD feels the same way about the application of the FHA.

**Redlining.** Attention to geographic lending patterns also promises to continue to be front and center within fair lending enforcement circles in 2024. Banks must continue to be diligent in assessing their lending footprints (whether called a Reasonably Expected Market Area, or REMA, service area, lending area, trade area, or otherwise) to ensure there are no indicators of redlining.

**Fair lending oversight.** Oversight of fair lending activities may also expand in 2024. Among others, in April 2023 the Federal Housing Finance Authority (FHFA), the regulator of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, issued a proposal that would codify several existing practices and programs relating to its fair lending oversight requirements for those entities. In what form that oversight will take is unknown at this point, but if nothing else it signifies the increasing attention federal regulatory agencies are placing on fair lending issues. More of the same can be expected as time goes on.

**ECOA applicability.** One interesting development to watch in the courts in 2024 is the application of ECOA itself. In early 2023 a federal District Court ruled that ECOA applied only to "applicants" for credit (as that is the term specified in the statute) and therefore not to "prospective applicants" within the context of advertising. This issue has been simmering for a few years, and later in 2023 the CFPB issued a Statement of Interest in another case stating that ECOA (and Regulation B) applies "to any aspect of a credit transaction," and therefore covers every aspect of a borrower's dealings with a creditor. While this shouldn't portend any major re-interpretation of the reach of ECOA, it will be very interesting to see how this issue evolves as it winds its way through the courts.

**Adverse action notices.** In the category of transactional compliance with Regulation B, banks can expect scrutiny of their adverse action notices, particularly if they utilize any sort of artificial intelligence (AI), models, or algorithms in their decisioning. This reflects guidance issued in September 2023 by the CFPB stating that creditors that they must disclose specific reasons for adverse action, even if consumers may be surprised, upset, or angered to learn their credit applications were being graded on data that may not intuitively relate to their finances (which may have been utilized in an automated model). The guidance specifies that creditors are not absolved from Regulation B's requirement to specifically and accurately inform consumers of the reasons for denial because the use of predictive decision-making technologies in their underwriting models makes it difficult to pinpoint the specific reasons for such adverse actions.

As the use of such automated decision-making models increases, expect this type of scrutiny to continue in 2024.

**Artificial intelligence, models, and algorithms.** Speaking of AI and algorithms, adverse action notices are but the tip of the iceberg when it comes to attention to AI's impact on the banking industry. Numerous issuances on the risks (as well as the benefits) to the financial services industry of AI, algorithms, and use of so-called nontraditional data were published in 2023 (as in prior years), and more can be expected in 2024. A Joint Statement from the CFPB, DOJ, Federal Trade Commission (FTC), and Equal Employment Opportunity Commission (EEOC) is especially noteworthy, as it reaffirmed their commitment to protect the public from bias in automated systems and artificial intelligence (AI). CFPB Director Chopra published comments stating the bureau will continue to collaborate with other agencies to enforce federal consumer financial protection laws, regardless of whether the violations occur through traditional means or advanced technologies. Further, the privacy protections in the proposed open banking rule could have implications for data used to train AI models.

Banks would be well-served to continue their focus on how these new technologies are utilized within their operations, but especially within marketing and credit functions, to understand how pervasive their use is, so that they can better understand and articulate the risks involved, but also

to take steps to properly mitigate them. The agencies use terms such as “digital redlining” and “algorithmic discrimination” in their publications; we can count on examinations and enforcement addressing these topics continuing into the foreseeable future.

### Other areas of focus

**Fees.** Attention on fees has been a theme for a few years now, with the President’s Junk Fees Initiative being front and center. As time has gone on, we’ve slowly been seeing guidance on what precisely would constitute a “junk” fee in the agencies’ eyes, meaning what fees should not be assessed at all, and for those fees that are assessed, how high a charge would be considered too high? Last March the administration convened a gathering of state legislative leaders to discuss fees, that in the administration’s view are “unnecessary, unavoidable, or surprise charges” that obscure true prices and are often not disclosed upfront. The same day, the CFPB published a special issue of its Supervisory Highlights focusing on fees in deposit accounts and the auto, mortgage, student, and payday loan servicing markets, which contained many examples of fees of which the administration is critical.

A related issuance came from the bureau in October 2023 in the form of an Advisory Opinion on consumers’ requests for information regarding their accounts with large institutions under Dodd-Frank Act section 1034(c). Director Chopra asserts that institutions should not charge excessive fees when trying to manage their finances.

There is no reason to expect attention to fees will wane in 2024; to the contrary, we can likely expect even more scrutiny. Banks would be wise to continue vigilance on fee structures, with the goal of “transparency and full disclosure in pricing,” to quote a phrase commonly heard by regulators when discussing this topic.

**Overdraft and non-sufficient funds (NSF) issues.** Attention to overdraft fees will certainly continue. Much was published in 2023 by several agencies, including reports of larger banks drastically changing their overdraft and NSF fee practices (including reducing fees), and many



discontinuing overdraft fees altogether. The CFPB has also mentioned several times that they are considering regulating overdraft plans as “consumer credit” under Regulation Z, although nothing formal to that effect has been issued yet. If this happened, it would be a major change in how overdraft plans are handled, so we’ll certainly keep a close eye on that possibility.

Additional guidance on repeat NSF fees and so-called “authorized positive, settled negative” (APSN) overdraft fees has sent a clear signal to banks to monitor whether these situations are occurring, and to determine whether disclosures may need to be strengthened or whether the bank needs to eliminate the fee.

Reminder: “Seasoned qualified mortgages,” or QMs, classification begins March 1. One issue to keep an eye on early in 2024 is the CFPB’s actions (if any) on the so-called “Seasoned QM” rule. Part of Regulation Z’s Ability-to-Repay (ATR) standard, this provision allows for certain mortgage loans originated outside of the rule’s QM criteria to become later become QMs by virtue of having three years of good payment history. This provision was effective March 1, 2021, and was not retroactive, meaning only loans originated on that date or thereafter could be eligible to later become seasoned QMs (but again only after three years). That date is now approaching, meaning some banks will have loans in their portfolios that newly become “safe harbor” QMs on the three-year anniversary of origination.

The only potential fly in the ointment here is a statement made by the bureau in early 2021, where it stated that the “Bureau is considering whether to initiate a rulemaking to revisit the Seasoned QM Final Rule.” That hasn’t happened yet (and hopefully at this late date will not), but it is an issue to keep an eye on, as various lenders have been preparing for some loans to gain this valuable status soon.

### **Crypto: A topic to watch**

With the evolution of the financial services business to a more digital model, we can expect increased regulatory interest in the risks that new technologies present. Chief among these is

cryptocurrencies and related crypto assets. It is not a matter of if, but rather when, retail banks embrace these products and offer them to their customers; in fact, it is already happening in a number of places (whether directly or through third parties). Consumers want to take advantage of the latest and greatest, and when returns on traditional products stagnate, banks face the risk of deposit runoff if they don't keep up.

Within the past few years, there have been multiple issuances and warnings from various agencies about the risks of crypto assets, including from the White House. The OCC, Federal Reserve and FDIC in April 2023 issued a joint statement regarding their concerns about liquidity, safety and soundness, consumer protection and other compliance risks to banks tied to crypto assets. And the Securities and Exchange Commission (SEC) has taken steps to enhance consumer protections for cryptocurrency assets by proposing to implement measures under the Investment Advisors Act of 1940 to address how client assets are safeguarded. It seems to be only a matter of time before the banking regulators address this gap in oversight of new product offerings, both from a safety and soundness as well a consumer protection standpoint. Banks thinking taking the plunge into crypto should monitor this situation carefully.

## Looking forward

While plenty is known about what is coming in 2024, let's end where we began: There always seem to be a few developments that take us all by surprise, and we look back and think how we could never have anticipated that event. Change is the only constant, and banks' processes must be fine-tuned to detect all that happens in a rapidly-changing regulatory environment.

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## TOP FEDERAL RESERVE COMPLIANCE VIOLATIONS IN 2022 UNDER THE FAIR CREDIT REPORTING ACT AND THE EQUAL CREDIT OPPORTUNITY ACT

BY DOLORES COLLAZO, SENIOR FINANCIAL INSTITUTION POLICY ANALYST,  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

As announced in the First Issue 2023, *Consumer Compliance Outlook (CCO)* is regularly publishing data-driven articles that leverage the Federal Reserve System's supervisory information from consumer compliance examinations of state member banks.<sup>1</sup> The articles analyze this information at an aggregate level to review top-cited violations, root causes, common pitfalls, and sound practices to mitigate risks.

As the Federal Reserve examination data in **Table 1** (page 8) indicate, the top consumer compliance violations in 2022 include violations of Regulation B, which implements the Equal Credit Opportunity Act (ECOA), and provisions of the Fair Credit Reporting Act (FCRA). More specifically, the violations involved the adverse action notice (AAN) requirements of Regulation B and the FCRA, the Regulation B spousal signature requirements for individual, creditworthy applicants, and the Regulation B requirement to provide a copy of all appraisals and other written valuations to applicants for a first-lien, dwelling-secured mortgage, as well as a notice of the right to obtain these documents not later than three business days after receiving an application for credit secured by a first lien on a dwelling.

This is a two-part article: The first section discusses the technical regulatory requirements, the root causes of violations, and common pitfalls, while the second section discusses sound practices and compliance management system enhancements that may mitigate the risks of violating these provisions.

### PART 1 — COMMON FCRA AND ECOA VIOLATIONS

The format for the common violations articles is to first list the regulatory requirements (either by quoting the verbatim text or by summarizing it) and then discuss the violations, root causes, and sound practices.

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# TOP FEDERAL RESERVE SYSTEM VIOLATIONS IN 2022: REGULATION E ERROR RESOLUTION REQUIREMENTS AND REGULATION X ESCROW ACCOUNT REQUIREMENTS

BY KATE LOFTUS, EXAMINER, FEDERAL RESERVE BANK OF MINNEAPOLIS

As discussed in the cover article in this issue, *CCO* is regularly publishing articles that leverage Federal Reserve supervisory data. The 2022 data (see the table on page 8) reveal that violations of the Electronic Fund Transfer Act (Regulation E) and the Real Estate Settlement Procedures Act (Regulation X) were among the most cited consumer compliance violations in examinations of state member banks in 2022. This article discusses violations of Regulations E and X, examiner observations, and sound practices to mitigate associated compliance risks.

## REGULATORY REQUIREMENTS

### Regulation E — Electronic Fund Transfer Act

#### 12 C.F.R. §1005.11(c) Time Frames for Investigating Errors

**Ten business days:** A financial institution shall promptly investigate and determine whether an error occurred within 10 business days of receiving a notice of error (20 business days if the notice of error involved an electronic fund transfer (EFT) to or from a new account within 30 days after the first deposit to the account was made).<sup>1</sup> The bank is not required to provide provisional credit.

**Forty-five days:** If the institution cannot complete an investigation within 10 business days (20 business days for a new account), it may take up to 45 days from receipt of a notice of error to investigate and determine if an error occurred, provided the institution:<sup>2</sup>

- provisionally credits the consumer's account for the amount of the alleged error within 10 business days of receiving the error notice;<sup>3</sup> and
- informs the consumer within two business days after provisional crediting and provides full use of the funds during the investigation.<sup>4</sup>

**Ninety days:** An institution may take up to 90 days in place of 45 days to complete an investigation if a notice of error involves an EFT that was not initiated within the state, resulted from a point of sale debit card transaction, or occurred within 30 days after the first deposit to the account was made.<sup>5</sup> The bank is required to provide provisional credit.

The Electronic Fund Transfer Act (EFTA), as implemented by Regulation E, provides the legal framework for the rights, liabilities, and responsibilities of participants in EFTs involving a consumer's checking, savings, or other asset account held by a financial institution.<sup>6</sup>

If a consumer notifies a financial institution that an *error* occurred with an EFT, the institution must investigate and notify the consumer of its findings and the action taken to resolve the error. The regulation defines an *error* as follows:

- an unauthorized EFT;
- an incorrect EFT to or from the consumer’s account;
- the omission of an EFT from a periodic statement;
- a computational or bookkeeping error made by the financial institution relating to an EFT;
- the consumer’s receipt of an incorrect amount of money from an electronic terminal;
- an EFT not identified in accordance with §1005.9 or §1005.10(a); or
- the consumer’s request for documentation required by the regulation or for additional information or clarification concerning an EFT, including a request the consumer makes to determine whether an error exists under the regulation.<sup>7</sup>

The regulation further clarifies this definition by providing these examples of inquiries that are not errors:

- a routine inquiry about the consumer’s account balance;
- a request for information for tax or other recordkeeping purposes; or
- a request for duplicate copies of documentation.

Section 1005.11(c) requires institutions to investigate errors within certain time frames as applicable. Examiners commonly observed these violations and the underlying causes:

- **Not promptly investigating.** Examination reports indicate some financial institutions were not promptly initiating error resolution investigations after the consumer notified them of an error, in violation of §1005.11(c). These errors typically occurred because bank staff did not recognize when consumers were making error resolution claims, did not know how to initiate investigations, or did not correctly identify all of the disputed transactions.
- **Not providing provisional credit.** Examiners cited institutions for violating §1005.11(c)(2)(i) by not providing provisional credit for the amount of the alleged error within 10 business days of receiving an error notice when the institutions could not complete their investigation within 10 business days and took up to 45 days to investigate under §1005.11(c)(2). Examiners also cited institutions that provisionally credited accounts but failed to provide full access to

and use of the funds during the investigation. These errors occurred because the institutions lacked effective procedures, controls, monitoring, and/or training to ensure compliance with the regulation.

- **Not conducting an adequate investigation.** Examiner data also showed some institutions conducting inadequate investigations of error claims. As stated in a prior *CCO* article: “A financial institution cannot deny a consumer’s claim of an error without conducting a reasonable investigation, unless it corrects the error as alleged by the consumer. A reasonable investigation includes reviewing relevant information within the institution’s records. If this review confirms the error, the claim cannot be denied. When the alleged error is an unauthorized EFT, the EFTA places the burden of proof on the financial institution to establish the transaction was authorized.<sup>8</sup> Therefore, if the institution cannot establish the disputed EFT transaction was authorized, the institution must credit the consumer’s account.”<sup>9</sup>

These errors occurred because staff either did not review or research all the transactions the consumer disputed or denied claims because of prior disputed transactions with the same merchant. Examiners identified root causes as not providing effective policies and procedures and not conducting adequate training and monitoring.

## REGULATORY REQUIREMENTS

### **Regulation E — Electronic Fund Transfer Act 12 C.F.R. §1005.11(d) Procedure When an Error Did Not Occur or Did Not Occur as Alleged**

After an institution completes its investigation, if it determines an error did not occur, or one occurred that differs in the manner or amount the consumer alleged, the institution must notify the consumer in writing of the results of its investigation and the consumer’s right to request the documents the institution relied on in making its determination.<sup>10</sup> If the institution debits a provisional credit, it must also notify the consumer of the date and amount of debiting and that the institution will honor checks, drafts, or similar instruments payable to third parties and preauthorized transfers from the consumer’s account for five business days after the notification (without charge to the consumer as a result of an overdraft).<sup>11</sup>

Examiners cited institutions for not explaining the results of an investigation and not providing a notice to the consumer of the right to request the documents the institution relied on in making its determination. These errors occurred primarily because staff did not adhere to the institution’s policies and procedures.

## SOUND PRACTICES TO MITIGATE REGULATION E RISKS

Sound practices can help limit these types of violations, including:

- **Providing enhanced procedures.** Adopting sufficiently detailed error resolution procedures can help ensure staff comply with regulatory requirements. Procedures may include, but are not limited to, instructions for gathering sufficient and accurate information upon notice of an error by a consumer, what constitutes a thorough investigation, how consumer engagement should occur, and how to document the process throughout.
- **Conducting training.** Training is an important tool for helping to proactively prevent or minimize violations. The requirements of §1005.11 are technical and nuanced. Periodic training can help to reinforce compliance staff’s understanding of the requirements and clarify any ambiguities.
- **Monitoring Regulation E compliance.** Bank management can regularly monitor the effectiveness of its controls, including Regulation E processes and procedures. To do this, bank management may consider conducting periodic reviews of notices of error, and completed investigations, to ensure that staff are adhering to established procedures and deadlines. Reviewing data points can also help identify violations. If a high percentage of error investigations are resolved in the bank’s favor, the bank may want to review a sample to ensure they complied with the regulation.
- **Enhancing consumer complaint response.** Several of the Regulation E errors discussed here were identified through consumer complaints. Institutions can regularly review complaint activity to identify and address Regulation E errors that may not have been identified through monitoring reviews to help ensure compliance.

## REGULATORY REQUIREMENTS

### Regulation X — Real Estate Settlement Procedures Act 12 C.F.R. §1024.17(c) Escrow Requirements

Section 17(c) specifies the procedures for administering an escrow account, including the following requirements:

- Payments generally cannot not exceed the “target balance,” which is defined as “the estimated month end balance in an escrow account that is just sufficient to cover the remaining disbursements from the escrow account in the escrow account computation year, taking into account the remaining scheduled periodic payments, and a cushion, if any,” which cannot exceed one-sixth of the estimated total payments from the escrow account, with certain exceptions in the case of a shortage or deficiency.
- “Before establishing an escrow account, the servicer must conduct an escrow account analysis to determine the amount the borrower must deposit into the escrow account..., and the amount of the borrower’s periodic payments into the escrow account,” subject to the limitations discussed above.<sup>12</sup>
- Thereafter, the servicer must conduct an escrow account analysis at the end of the escrow account computation year to determine the borrower’s monthly escrow account payments for the next computation year and use that analysis to determine whether a surplus, shortage, or deficiency exists and make required adjustments as appropriate.<sup>13</sup>
- A servicer may issue a short-year annual escrow account statement to change one escrow account computation year to another. The short-year statement must end the escrow account computation year and establish the beginning date of the new escrow account computation year. The servicer shall deliver the short-year statement to the borrower within 60 days from the end of the short year.<sup>14</sup>
- If a surplus exists, which is defined as a balance in excess of the target balance for the account, it must be refunded within 30 days from the date of the analysis if it is \$50 or greater. If the surplus is less than \$50, the servicer can either refund it within 30 days or credit it to the escrow account for the next year.<sup>15</sup>
- The aggregate accounting method must be used to conduct the escrow account analyses.<sup>16</sup>
- Where the borrower is required to make payments to an escrow account, the servicer must also ensure it makes timely disbursements “on or before the deadline to avoid a penalty, as long as the borrower’s payment is not more than 30 days overdue.”<sup>17</sup>
- If an escrow disbursement is billed for periods longer than one year (for example, a flood insurance premium payable every three years), the servicer must estimate the borrower’s payments for a full cycle of disbursements (using the flood premium example, by dividing the three-year period into 36 monthly payments).<sup>18</sup>

The Real Estate Settlement Procedures Act (RESPA),<sup>19</sup> as implemented by Regulation X, provides the legal framework of consumer protections for the servicing of *federally related mortgage loans*, as defined in 12 C.F.R. §1024.2(b).<sup>20</sup> These protections include the procedures in §17(c) servicers must follow for a federally related mortgage loan with an escrow account, which lenders may require to pay real estate taxes, insurance premiums, and other mortgage-related disbursements.

Examiners frequently found bank staff inaccurately computed and disclosed the initial and annual escrow analyses. Incorrect system settings and payment amount issues typically caused these errors. For the system settings, bank staff erroneously used the payment *due date* rather than the *anticipated disbursement date* as the disbursement date for escrow items on the initial and annual escrow analyses. Using the payment due date rather than the anticipated disbursement date resulted in computation and disclosure errors on the initial and annual escrow account analyses. For the payment amount issue, bank staff itemized the incorrect number of payments from the escrow account on the initial and annual escrow account analyses, resulting in inaccurate initial and annual escrow computations and projections.

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“ Given the technical nature of escrow-related rules, adopting sufficiently detailed escrow procedures is important to help ensure bank staff set up and manage escrow accounts appropriately. ”

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Examiners also observed errors related to bank staff conducting annual escrow account analyses beyond the 12-month computation year, without issuing short-year statements as required under the regulation. In these cases, staff conducted annual escrow analyses for all loans during the same month. If a loan was originated outside of this month, an annual escrow account analysis was not prepared until the loan aligned with the bank’s escrow analysis schedule. This resulted in staff not conducting timely annual escrow account analyses, as §1024.17(c)(3) requires.



## SOUND PRACTICES TO MITIGATE RESPA RISKS

Several sound risk management practices can facilitate compliance with escrow account requirements:

- **Increasing oversight.** Implementing approval processes and/or secondary levels of review for changes to system settings, for example, is one way to help ensure compliance with the regulation.
- **Enhancing escrow procedures.** Given the technical nature of escrow-related rules, adopting sufficiently detailed escrow procedures is important to help ensure bank staff set up and manage escrow accounts appropriately and provide accurate and timely disclosures to borrowers.
- **Conducting regular training.** Providing regular and detailed training on escrow-related rules, particularly for mortgage origination and servicing staff, can help to ensure that staff understand how to manage the escrow accounts appropriately and comply with regulatory requirements. Additionally, institutions may want to consider establishing a training schedule with appropriate training frequency, as well as a tracking mechanism to ensure required trainings are satisfactorily completed.

## CONCLUSION

This article discussed the most common Regulation E and X violations from 2022 and sound risk management practices institutions can consider to help mitigate compliance risk. Specific issues and questions related to these regulations should be raised with your primary regulator. ■



## Resources

- ⇒ Richele S. Brady, “Escrow Accounting Rules: Are You in Compliance?,” *CCO* (Second Issue 2018)
- ⇒ Kenneth Benton and Robert Sheerr, “Error Resolution Procedures and Consumer Liability Limits for Unauthorized Electronic Fund Transfers,” *CCO* (Fourth Quarter 2012)
- ⇒ Scott Sonbuchner, “Error Resolution and Liability Limitations Under Regulations E and Z: Regulatory Requirements, Common Violations, and Sound Practices,” *CCO* (Second Issue 2021)
- ⇒ Kathleen Benson, “Enhancing Your Compliance Training Program,” *CCO* (First Issue 2019)
- ⇒ RESPA Interagency Examination Procedures
- ⇒ EFTA Interagency Examination Procedures

## ENDNOTES\*

<sup>1</sup> 12 C.F.R. §1005.11(c)(1) and (c)(3)(i).

<sup>2</sup> 12 C.F.R. §1005.11(c)(2).

<sup>3</sup> 12 C.F.R. §1005.11(c)(2)(i).

<sup>4</sup> 12 C.F.R. §1005.11(c)(2)(ii).

<sup>5</sup> 12 C.F.R. §1005.11(c)(3)(ii).

<sup>6</sup> 12 C.F.R. §1005.2(b)(1).

<sup>7</sup> 12 C.F.R. §1005.11(a).

<sup>8</sup> 15 U.S.C. §1693g(b).

<sup>9</sup> Scott Sonbuchner, “Error Resolution and Liability Limitations Under Regulations E and Z: Regulatory Requirements, Common Violations, and Sound Practices,” *CCO* (Second Issue 2021).

<sup>10</sup> 12 C.F.R. §1005.11(d)(1).

<sup>11</sup> 12 C.F.R. §1005.11(d)(2).

<sup>12</sup> 12 C.F.R. §1024.17(c)(2).

<sup>13</sup> 12 C.F.R. §1024.17(f) and (c)(3). An exception applies if a servicer is issuing a short-year statement to change one escrow account computation year to another. See 12 C.F.R. §1024.17(i)(4).

<sup>14</sup> 12 C.F.R. §1024.17(i)(4)(i).

<sup>15</sup> 12 C.F.R. §1024.17(f)(2)(i).

<sup>16</sup> 12 C.F.R. §1024.17(c)(4).

<sup>17</sup> 12 C.F.R. §1024.17(k)(1).

<sup>18</sup> 12 C.F.R. §1024.17(c)(9).

<sup>19</sup> 12 U.S.C. §2601 et seq.

<sup>20</sup> 12 C.F.R. §1024.5(a), (b), and (d).

\* Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at [consumercomplianceoutlook.org](http://consumercomplianceoutlook.org).



## TOP FEDERAL RESERVE COMPLIANCE VIOLATIONS IN 2022 UNDER THE FAIR CREDIT REPORTING ACT AND THE EQUAL CREDIT OPPORTUNITY ACT

### REGULATORY REQUIREMENTS

#### Fair Credit Reporting Act Adverse Action Notice Requirements §615(a) Duties of users taking adverse actions on the basis of information contained in consumer reports

If a user of a consumer report takes adverse action, as defined in FCRA §603(k), with respect to any consumer based, in whole or in part, on information in the report, the user must provide the consumer an AAN with the following information:

- Notice of the adverse action taken based on information obtained from a consumer reporting agency
- Notice of the consumer’s right to:
  - Obtain a free copy of the person’s consumer report from the consumer reporting agency providing the information if requested within 60 days
  - Dispute with a consumer reporting agency the accuracy or completeness of any information in a consumer report furnished by the consumer reporting agency
- The name, address, and telephone number of the consumer reporting agency that furnished the report to the person
- A statement that the consumer reporting agency did not make the credit decision and is unable to provide to the consumer the specific reasons why the adverse action was taken

If a credit score was a factor in taking adverse action, the following information must be provided:

- The numerical credit score used and the date on which it was created
- The range of possible credit scores under the model used
- The key factors that adversely affected the credit score
- The name of the person or entity providing the credit score or the information upon which score was created

Examiners cited violations for not providing an accurate or complete AAN to affected applicants. Common violations included:

- Not including the range of possible credit scores under the scoring model used. Disclosing the range of scores is critical because different models use different ranges.
- Not providing an AAN when taking adverse action based, in whole or in part, on information in a consumer report.
- Taking adverse action based, in whole or in part, on a credit score, but not including the credit score disclosures specified in FCRA §609(f)(1) in the AAN. The credit score does not have to be the primary reason adverse action is taken. *The credit score disclosures are required whenever a score is used in the decision to take adverse action.*

Common issues include inadequate training, controls, and procedures.

An FCRA AAN alerts consumers that adverse action was taken because of negative information in their credit reports and provides them the right to obtain a free copy of their reports so they can review them and file disputes if the reports contain inaccurate information.<sup>2</sup> To comply, users of consumer reports and credit scores must know the scope of transactions subject to FCRA AAN requirements.

For credit transactions, the FCRA applies the definition of *adverse action* in §701(d)(6) of the ECOA.<sup>3</sup> This includes taking adverse action on an existing credit account.<sup>4</sup> For example, many creditors periodically conduct reviews of their consumer accounts, which often include pulling credit reports. Suppose, for example, a credit card issuer reviews the credit reports of its consumer accounts and reduces the credit limit for any account showing 60-day or 90-day late payments with other creditors. Because the creditor is taking adverse action on a credit account based, in whole or part, on information in a consumer report, an FCRA AAN is required.

For noncredit transactions, FCRA adverse action includes taking negative action, based, in whole or in part, on information in a consumer report, for:

- an existing noncredit account during account review to determine if the consumer continues to meet the terms of the account;

**TABLE 1: Top Consumer Violations in 2022 for State Member Banks**

	<b>Provision</b>	<b>Violations</b>	<b>% of All Violations</b>
<b>1</b>	Regulation C (Home Mortgage Disclosure Act), 12 C.F.R. §1003.4(a): requires a financial institution to collect specific data on applications for covered loans it receives, originates, and purchases for each calendar year.	239	59.4
<b>2</b>	Regulation BB (Community Reinvestment Act), 12 C.F.R. §228.42(a): requires a bank to collect and maintain specific data for each small business or small farm loan originated or purchased by the bank.	29	7.2
<b>3</b>	Regulation E (Electronic Fund Transfers Act), 12 C.F.R. §1005.11(c): requires a financial institution to perform an investigation and determine whether an error occurred within 10 business days of receiving a notice of error.	9	2.2
<b>4</b>	Regulation E (Electronic Fund Transfers Act), 12 C.F.R. §1005.11(d): requires a financial institution to respond to a consumer’s notice of error in writing if it determines no error occurred or an error occurred in a manner or amount different from the one the consumer described.	6	1.5
<b>5</b>	(tie) Fair Credit Reporting Act, 15 U.S.C. §1681m(a): requires a financial institution taking adverse action against a consumer based in whole or in part on information in a consumer report to provide an adverse action notice.	5	1.2
<b>6</b>	Regulation B (Equal Credit Opportunity Act), 12 C.F.R. §1002.7(d): prohibits a creditor from requiring the signature of an applicant’s spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor’s standards of creditworthiness for the amount and terms of the credit requested.	5	1.2
<b>7</b>	Regulation B (Equal Credit Opportunity Act), 12 C.F.R. §1002.9(a): requires a creditor to notify an applicant within 30 days after receiving a completed application concerning the creditor’s approval of, counteroffer to, or adverse action on the application.	5	1.2
<b>8</b>	Regulation B (Equal Credit Opportunity Act), 12 C.F.R. §1002.14(a): requires a creditor 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.	5	1.2
<b>9</b>	Regulation X (Real Estate Settlement Procedures Act), 12 C.F.R. §1024.17(c): sets limits on the amount a servicer can require a borrower to deposit into any escrow account created in connection with a federally related mortgage loan.	5	1.2

Note: These data were based on 211 examinations, in which examiners cited 402 violations.

- applications and transactions initiated by a consumer, such as a consumer applying to a financial institution to open a checking account;
- insurance policies; and
- employment decisions.<sup>5</sup>

When a creditor is required to provide AANs under both the FCRA and ECOA/Regulation B, the notices may be combined to facilitate compliance and reduce regulatory burden. Model AANs are available in Appendix C of Regulation B (forms C-1 through C-6), including combined FCRA/ECOA forms.

## REGULATORY REQUIREMENTS

### Regulation B — Equal Credit Opportunity Act 12 C.F.R. §1002.9(a) Notification of action taken, ECOA notice, and statement of specific reasons

**(1) When notification is required.** A creditor shall notify [a consumer] applicant of action taken within:

**(i)** 30 days after receiving a completed application concerning the creditor’s approval of, counteroffer to, or adverse action on the application;

**(ii)** 30 days after taking adverse action on an incomplete application, unless notice is provided in accordance with paragraph (c) of this section;

**(iii)** 30 days after taking adverse action on an existing account; or

**(iv)** 90 days after notifying the applicant of a counteroffer if the applicant does not expressly accept or use the credit offered.

In contrast to the FCRA, which is generally limited to consumer transactions, Regulation B adverse action requirements apply to both consumer and business transactions. For these provisions, examiners cited financial institutions for failing to provide timely AANs in accordance with the regulation. A creditor must provide an AAN to the applicant within 30 days after receiving a complete credit application. This requires bank staff to know when a credit application is “complete.” The commentary clarifies that a *completed application* is defined “in terms that give a creditor the latitude to establish its own information requirements.”<sup>6</sup> Thus, members of an institution’s lending staff must ensure they understand their institution’s definition of a completed application, which starts the 30-day clock if adverse action is being taken.

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“ If the applicant provides sufficient data for a credit decision, even though information is missing, the creditor may evaluate the application, make its credit decision, and notify the applicant accordingly. If credit is denied because the application is incomplete, an AAN is required.”

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For business credit applications, §1002.9(a)(3)(ii) provides these requirements:

- For businesses with gross revenues of \$1 million or less in the preceding fiscal year, the general adverse action requirements apply, except that:
  - the notice of action taken may be given orally or in writing;
  - the creditor may disclose an applicant’s right to the statement of reasons at the time of application instead of when adverse action is taken, if the creditor lets the applicant know they have 60 days to request the reasons, and the disclosure includes the ECOA notice; and
  - for an application taken entirely by telephone, the creditor may provide an oral statement of the action taken and the applicant’s right to the statement of reasons for adverse action.<sup>7</sup>
- Businesses with gross revenues greater than \$1 million in the preceding fiscal year must:
  - notify the applicant, within a reasonable time, orally or in writing, of the action taken; and
  - provide the statement of reasons for adverse action in writing and the ECOA notice if the applicant makes a written request for the reasons within 60 days of the notice.<sup>8</sup>

Also, if the applicant provides sufficient data for a credit

decision, even though information is missing, the creditor may evaluate the application, make its credit decision, and notify the applicant accordingly. If credit is denied because the application is incomplete, an AAN is required.<sup>9</sup> If the creditor requires additional information, it may send a notice of incompleteness.<sup>10</sup>

In addition to the timing requirements, the violations cited involved not providing an accurate and complete AAN. Financial institutions should remember that AANs should include the following information:

- The specific reasons for the action taken<sup>11</sup>
- The creditor’s name and address
- The ECOA notice regarding prohibited discrimination
- The name and address of the creditor’s federal agency that administers compliance

Instead of providing the reasons for the action taken, a creditor may provide a disclosure of the applicant’s right to receive the specific reasons. For this option, the notice must indicate that the applicant should request the reasons within 60 days of the disclosure date. The creditor should respond within 30 days of the applicant’s request.

The root causes of these violations include inadequate training and failing to implement controls to ensure procedures are consistently followed.

## REGULATORY REQUIREMENTS

### **Regulation B — Equal Credit Opportunity Act 12 C.F.R. §1002.7(d) Signature of spouse or other person**

**(1) Rule for qualified applicant.** Except as provided in this paragraph, a creditor shall not require the signature of an applicant’s spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor’s standards of creditworthiness for the amount and terms of the credit requested. A creditor shall not deem the submission of a joint financial statement or other evidence of jointly held assets as an application for joint credit.

Examiners cited financial institutions that required individual, creditworthy applicants to obtain the signature of their spouse or another person as a condition of their loan in violation of the regulation. Comments 7(d)(1)-1, -2, and -3 to Regulation B clarify the requirements for evaluating individual, creditworthy applicants:

- The creditor cannot require the applicant to provide a cosigner.

- A “joint applicant” is someone who applies contemporaneously with the applicant for joint credit, not someone required as a condition for the loan.
- A person’s intent to be a joint applicant must be evidenced at the time of application. Signatures on a joint financial statement confirming the information is accurate and complete are not sufficient to establish intent to apply for joint credit.

The regulation has an exception when a loan is secured by collateral jointly owned with a spouse, and the spouse’s signature is necessary under state law to reach the collateral in the event of default.<sup>12</sup> If state law requires the spouse’s signature on both the security instrument *and* the note, the creditor may require the spouse’s signature on both. But if state law requires the spouse’s signature only on the security instrument, the creditor may not require the spouse to cosign or guarantee the note evidencing the credit agreement.<sup>13</sup>

The root causes of these violations include inadequate training and the lack of controls to ensure that procedures are properly implemented.

## REGULATORY REQUIREMENTS

### **Regulation B — Equal Credit Opportunity Act 12 C.F.R. §1002.14(a) Providing appraisals and other valuations**

**(1) In general.** A creditor shall 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. A creditor shall provide a copy of each such appraisal or other written valuation promptly upon completion, or three business days prior to consummation of the transaction (for closed-end credit) or account opening (for open-end credit), whichever is earlier. ...

**(2) Disclosure.** For applications subject to paragraph 14(a)(1) of this section, a creditor shall mail or deliver to an applicant, not later than the third business day after the creditor receives an application for credit that is to be secured by a first lien on a dwelling, a notice in writing of the applicant’s right to receive a copy of all written appraisals developed in connection with the application. In the case of an application for credit that is not to be secured by a first lien on a dwelling at the time of application, if the creditor later determines the credit will be secured by a first lien on a dwelling, the creditor shall mail or deliver the same notice in writing not later than the third business day after the creditor determines that the loan is to be secured by a first lien on a dwelling.

Examiners cited financial institutions for not appropriately providing applicants a copy of appraisals or valuations<sup>14</sup> associated with a first-lien mortgage application. In several cases, inadequate training and inadequate procedures were the root causes.

In certain instances, applicants may waive the timing requirements prescribed in Regulation B, except where otherwise prohibited by law:

- An applicant may waive the timing requirements and agree to receive any copy at or before consummation or account opening.
- The institution must obtain a waiver at least three business days prior to consummation or account opening unless the waiver pertains only to an appraisal or valuation with clerical changes from a previous version provided to the applicant three or more business days prior to consummation or account opening.
- If an applicant provides a waiver and the transaction is not consummated or the account not opened, the institution must obtain the waiver no later than 30 days after that determination is made.

Violations were also cited for disclosure errors. In these instances, the creditor failed to mail or deliver a notice in

writing of the applicant’s right to receive a copy of all written appraisals or valuations developed in connection with the application, no later than the third business day after the creditor receives an application for a mortgage loan that is to be secured by a first lien on a dwelling.<sup>15</sup> In cases where it was not known at the time of application but was later determined during the application process that the loan would be secured by a first lien on a dwelling, financial institutions failed to provide the disclosure no later than the third business day after that determination.<sup>16</sup>

The root causes were often insufficient training and inadequate procedures and controls.

**PART 2 — SOUND PRACTICES TO MITIGATE COMPLIANCE RISKS**

The first part of this article explored the technical requirements of Regulation B and the FCRA. This part will highlight sound practices that can help institutions ensure compliance with those requirements.

**Table 2** lists sound compliance practices that examiners have observed at financial institutions and recommend.

<b>TABLE 2: Sound Compliance Practices</b>	
<p><b>Board and Senior Management Oversight</b></p> <ul style="list-style-type: none"> <li>• Tone at the top</li> <li>• Risk identification</li> <li>• Third-party oversight</li> </ul>	<ul style="list-style-type: none"> <li>• Convey the importance of compliance to help set expectations</li> <li>• Identify inherent risks related to processing credit applications (understand risks involved with manual processes and automated processes) for:               <ul style="list-style-type: none"> <li>○ Adverse action notices (FCRA and Regulation B)</li> <li>○ Individual creditworthiness (Regulation B)</li> <li>○ Appraisals/valuations (Regulation B)</li> </ul> </li> <li>• Ensure that third-party service providers understand and effectively perform their compliance responsibilities</li> </ul>
<p><b>Internal Controls</b></p>	<ul style="list-style-type: none"> <li>• Conduct a second review of AANs to identify errors missed during the initial review</li> <li>• Conduct a secondary review of loans subject to the appraisal requirements to ensure appraisals and notices were provided</li> </ul>
<p><b>Consumer Complaints</b></p>	<ul style="list-style-type: none"> <li>• Review complaints received by the institution or by the Federal Reserve Consumer Help complaint system for possible internal control weaknesses for the issues noted in this article, adjusting and strengthening processes as needed to ensure compliance</li> </ul>

**TABLE 2: Sound Compliance Practices (Continued)**

<p><b>Training</b></p> <ul style="list-style-type: none"> <li>• Current, tailored to the institution’s processes, and sufficiently detailed to guide staff</li> <li>• Tools</li> </ul>	<ul style="list-style-type: none"> <li>• Conduct regular training on the FCRA and ECOA adverse action notice requirements and the ECOA spousal signatures and appraisal requirements, tailored to the individual contributor’s role in the process</li> <li>• Identify and train for difficult situations in the process</li> <li>• Include training when regulatory changes and/or procedural weaknesses are noted</li> <li>• Provide flow charts and worksheets for staff</li> </ul>
<p><b>Monitoring and/or Audit (as applicable)</b></p> <ul style="list-style-type: none"> <li>• Tailored to the credit product offerings</li> </ul>	<ul style="list-style-type: none"> <li>• Validate that policies and procedures and training are effective</li> <li>• Perform transaction testing/sampling:             <ul style="list-style-type: none"> <li>○ Adverse action notices for timing and content in comparison to application and source documents to confirm timing and accuracy</li> <li>○ Individual and joint credit applications to ensure that creditworthy applicants were able to apply individually and that joint applicants confirmed status at the time of application</li> <li>○ Denied and approved loans secured by first lien on dwellings to ensure applicants and borrowers were provided appraisal/valuation, as applicable</li> </ul> </li> </ul>
<p><b>Policies and Procedures</b></p> <ul style="list-style-type: none"> <li>• Adequately cover the regulatory requirements and provide effective staff guidance</li> </ul>	<ul style="list-style-type: none"> <li>• Implement detailed policies and procedures to ensure a consistent and repeatable process. Considerations might include:             <ul style="list-style-type: none"> <li>○ Understanding triggers for AANs and timing requirements</li> <li>○ Ensuring that adverse action notices include elements required by the ECOA and the FCRA, as applicable</li> <li>○ Understanding different types of credit applicants, individual versus joint</li> <li>○ Evidencing joint applicants at time of application</li> <li>○ Providing copies of appraisals and valuations for first lien dwelling loans or compliant notice of right to receive appraisal</li> </ul> </li> </ul>

Financial institutions should determine through a review of their product offerings which sound practices best align with their operations and risk profile.

on areas in which they may have a higher risk of violations and how to respond. Specific issues and questions should be raised with your primary regulator. ■

**CONCLUDING REMARKS**

The discussion here of the top violations and sound practices to mitigate risks provides information to financial institutions



## Resources

- ⇒ Dolores Collazo, “Advanced Topics in Adverse Action Notices Under the Equal Credit Opportunity Act,” *CCO* (Fourth Issue 2021)
- ⇒ Sarah Ammermann, “Adverse Action Notice Requirements Under the ECOA and the FCRA,” *CCO* (Second Quarter 2013)
- ⇒ Carol Evans and Surya Sen, “Regulation B and Marital Status Discrimination: Are You in Compliance?,” *CCO* (Fourth Quarter 2008)
- ⇒ Interagency FCRA Examination Procedures
- ⇒ Consumer Financial Protection Circular 2023-03, “Adverse Action Notification Requirements and Proper Use of the CFPB’s Sample Forms Provided in Regulation B”
- ⇒ Consumer Financial Protection Circular 2022-03, “Adverse Action Notification Requirements in Connection with Credit Decisions Based on Complex Algorithms”

## ENDNOTES\*

- <sup>1</sup> Governor Michelle W. Bowman, “Introducing Our New Format,” *CCO* (First Issue 2023).
- <sup>2</sup> 15 U.S.C. §1681m(a)(4). See also Senate Hearing 108-579 (May 20, 2003).
- <sup>3</sup> 15 U.S.C. §1681a(k). See also §1002.2(c) of Regulation B.
- <sup>4</sup> 15 U.S.C. §1691(d)(6).
- <sup>5</sup> 15 U.S.C. §1681a(k)(1)(B). Congress added the catch-all provision in §1681a(k)(1)(B)(iv) to the FCRA in 1996 to overturn an FTC interpretation that stated that refusing to accept payment by check or rent an apartment based on a consumer report did not require an adverse action notice under the FCRA. See House Report No. 103-486 at 33 (1994): (“Additionally, the definition contains a catch-all phrase that makes clear that any action taken or determination made with respect to a consumer application or a consumer-initiated transaction that is adverse to the interest of the consumer constitutes an adverse action. This catch-all would include, for example, a refusal to cash a check, lease real estate, or open a new transaction account based on a consumer report. This new definition is intended to overturn a prior interpretation by the Federal Trade Commission (FTC), 55 Fed. Reg. 18826 (May 4, 1990), that refusal to accept payment by check or rent an apartment based on a consumer report does not trigger an adverse action notice under the FCRA.”) See also 76 FR 41590, 41597 (July 15, 2011); and *40 Years of Experience with the Fair Credit Reporting Act: An FTC Staff Report with Summary of Interpretations* at p. 84 (2011): (“A

business that takes adverse action against a consumer in a context other than credit, insurance, or employment (e.g., a residential landlord), based in whole or in part on a consumer report, must also provide an adverse action notice.”)

- <sup>6</sup> See Comment 2(f)-6 of Regulation B.
- <sup>7</sup> 12 C.F.R. §1002.9(a)(3)(i).
- <sup>8</sup> 12 C.F.R. §1002.9(a)(3)(ii).
- <sup>9</sup> 12 C.F.R. §1002.9(c)(1)(i).
- <sup>10</sup> 12 C.F.R. §1002.9(c)(1)(ii) and 9(c)(2).
- <sup>11</sup> Comment 9(b)(2)-1 of Regulation B clarifies that the “regulation does not mandate that a specific number of reasons be disclosed, but disclosure of more than four reasons is not likely to be helpful to the applicant.”
- <sup>12</sup> 12 C.F.R. §1002.7(d)(4).
- <sup>13</sup> Comment 7(d)(4)-1 of Regulation B.
- <sup>14</sup> Regulation B defines a valuation as “any estimate of the value of a dwelling developed in connection with an application for credit,” 12 C.F.R. §1002.14(b)(3).
- <sup>15</sup> 12 C.F.R. §1009.14(b).
- <sup>16</sup> 12 C.F.R. §1009.14(b).

\* Note: The links for the references listed in the Endnotes are available on the *Consumer Compliance Outlook* website at [consumercomplianceoutlook.org](https://consumercomplianceoutlook.org).

## INTERAGENCY OVERVIEW OF THE COMMUNITY REINVESTMENT ACT FINAL RULE

OCTOBER 2023

### BACKGROUND

On October 24, 2023, the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (Board), and the Federal Deposit Insurance Corporation (FDIC) issued a final rule to strengthen and modernize regulations implementing the Community Reinvestment Act (CRA) to better achieve the purposes of the law. The CRA is a landmark law enacted in 1977 to address systemic inequities in access to credit. The CRA encourages federally insured banks to help meet the credit needs of the communities in which they do business, especially low- and moderate-income (LMI) communities, consistent with safe and sound operations.

To facilitate compliance, the agencies jointly published this summary. They have also hosted a webinar that explains the rule. The final rule and other supporting materials (including a press release and fact sheet) can be found on the OCC, Board, and FDIC websites.

### OBJECTIVES AND KEY ELEMENTS OF FINAL RULE

The agencies recognize that the CRA regulations must evolve to address the significant changes in the banking industry that have taken place since the last comprehensive interagency update in 1995.

Building on feedback from stakeholders and research, the final rule updates the CRA regulations to achieve the following eight key objectives:

#### 1. Strengthen the achievement of the core purpose of the statute

The rule seeks to ensure that the CRA continues to be a strong and effective tool to address inequities in access to credit. To achieve this objective, the rule

- evaluates bank engagement with LMI individuals and communities, small businesses, and small farms, including conducting separate assessments of large bank activities using four tests: (1) retail lending, (2) retail services and products, (3) community development (CD) financing, and (4) CD services.

- enhances financial inclusion by supporting Minority Depository Institutions and Community Development Financial Institutions, Native Land Areas, persistent poverty areas, and other high-need areas.
- emphasizes smaller loans and investments that can have high impact and be more responsive to the needs of LMI communities.

#### 2. Adapt to changes in the banking industry, including the expanded role of mobile and online banking

The rule recognizes the significant changes in bank business models and how banking services are delivered, including through the use of internet and mobile banking and hybrid models that combine physical footprints with online lending. To achieve this objective, the rule

- maintains a focus on evaluating bank performance in areas where banks have deposit-taking facilities while also evaluating retail lending activities occurring in “Retail Lending Assessment Areas” outside of these areas. The new rule also provides consideration for banks’ community development activities nationwide.

#### 3. Provide greater clarity and consistency in the application of the regulations

The rule addresses feedback on the need for more clarity and consistency in the application of the CRA regulations. To achieve this objective, the rule

- adopts new metrics and benchmarks used by the agencies to assess retail lending performance that translate into performance conclusions.
- encourages CD activities that are responsive to the needs of LMI individuals and communities, small businesses, and small farms by clarifying what activities will receive CRA credit (such as affordable housing), providing for a public list and approval process to confirm an activity’s eligibility, and evaluating CD activities in light of their impact.

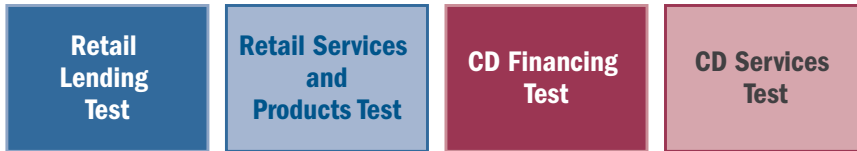


**FIGURE 1: Tailored Evaluation Framework**

The rule is tailored to differences in bank size and business models, with additional performance tests for large banks and flexibility for small banks to remain under the existing lending test or opt into the new Retail Lending Test. Intermediate banks also have the flexibility to remain under the existing CD test applicable to intermediate small banks under the current rule or opt into the new Community Development Financing Test. Limited purpose banks are evaluated under a tailored version of the Community Development Financing Test.

**Large Banks**

≥ \$2B



**Intermediate Banks**

Retail Lending Test and existing CD test or opt into CD Financing Test

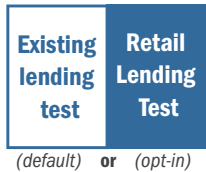
\$600M – <\$2B



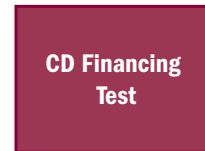
**Small Banks**

Existing lending test or opt into Retail Lending Test

<\$600M



**Limited Purpose Banks**



**4. Tailor performance standards to account for differences in bank size, business models, and local conditions**

The rule recognizes differences in bank size and business models. To achieve this objective, the rule

- updates asset size thresholds for small, intermediate, and large banks to account for changes in the banking industry: (1) small banks: <\$600M (from <\$376M); (2) intermediate banks: \$600M–<\$2B (from \$376M–\$1.503B); and (3) large banks: ≥\$2B (from ≥\$1.503B), adjusted annually for inflation.
- utilizes community and market benchmarks that reflect differences in local conditions.
- continues to provide a tailored performance evaluation framework with different performance tests based on bank size and business model (see **Figure 1**). For

example, small banks will continue to be evaluated under the existing framework with the option to be evaluated under the new framework.

**5. Tailor data collection and reporting requirements and use existing data whenever possible**

The rule seeks to strike an appropriate balance between minimizing unnecessary burden on community banks and providing greater clarity and consistency in how large banks are assessed by establishing the use of standardized metrics for certain banks and tailoring the associated data collection, maintenance, and reporting requirements. To achieve this objective, the rule

- exempts small and intermediate banks from new data collection requirements that apply to banks with assets of at least \$2 billion.

- limits certain data collection and reporting requirements to large banks with assets greater than \$10 billion.

## 6. Promote transparency and public engagement

The rule recognizes that transparency and public engagement are fundamental aspects of the CRA evaluation process. To achieve this objective, the rule

- provides greater transparency for existing data available under the Home Mortgage Disclosure Act (HMDA) — related to the race, ethnicity, and income of bank borrowers and applicants — for large banks, by assessment area. Data will be provided on agency websites for disclosure purposes only.
- codifies the practice of forwarding to the bank all public comments received by the agencies regarding a bank's CRA performance.
- encourages the public to submit comments on community needs and opportunities.
- provides in supplementary information that the agencies will develop data tools that use reported loan data to calculate metrics and benchmarks in different geographic areas in recent years, allowing banks and the public to have additional insight into the performance standards.

## 7. Confirm that CRA and fair lending responsibilities are mutually reinforcing

The rule affirms that, in meeting the credit needs of their entire communities, banks must do so in a fair and equitable manner. The rule

- continues to prohibit banks from delineating facility-based assessment areas (FBAs) that reflect illegal discrimination or arbitrarily exclude LMI census tracts.
- retains and clarifies the provision that CRA ratings can be downgraded as a result of discriminatory and other illegal credit practices.

## 8. Promote a consistent regulatory approach that applies to banks regulated by all three agencies

The rule recognizes the importance of consistency across the three agencies. The rule

- provides a unified approach from the three banking agencies that is responsive to feedback from stakeholders on the need for consistent regulations.

The agencies will continue their interagency work to ensure consistent implementation of a final rule through examiner and industry training, interagency examination procedures, and joint publication of an illustrative list of eligible CD activities.

## KEY CHANGES IN FINAL RULE

Based on an analysis of comment letters and further agency review, the final rule includes the following key changes from the proposed rule:

### 1. Reduces complexity and data requirements while providing a consistent and comprehensive approach to evaluating banks under the Retail Lending Test

- reduces the number of major product lines potentially evaluated under the new Retail Lending Test from six to three: (1) closed-end home mortgage loans; (2) small business loans; and (3) small farm loans
- limits the evaluation of automobile lending to banks subject to the Retail Lending Test that
  - are majority automobile lenders (i.e., banks for which more than 50 percent of their lending comprises automobile loan purchases or originations, out of total automobile, home mortgage, multifamily, small business, and small farm lending); or
  - opt to have their automobile lending evaluated

### 2. Adjusts retail lending performance ranges while maintaining high standards; also increases weighting of CD financing activities

- adjusts standards to make “Low Satisfactory,” “High Satisfactory,” and “Outstanding” conclusions under the Retail Lending Test more achievable while still maintaining appropriate and locally calibrated standards
- for large banks, gives equal weight to retail activities and CD activities (compared to a proposed 60 percent retail/40 percent CD split). The equal weight was broadly supported by stakeholders to encourage banks to focus on CD activities in addition to retail activities by providing additional emphasis in the banks' ratings.

\* Note: The links for the CRA resources discussed in this article are available on the Consumer Compliance Outlook website at [consumercomplianceoutlook.org](http://consumercomplianceoutlook.org).

### 3. Retains evaluation of banks with significant retail lending outside of branches while increasing tailoring of the retail lending assessment area approach

- tailors requirements for delineating retail lending assessment areas (RLAAs):
  - based on recent lending patterns, about one-quarter of large bank mortgage lending and nearly 40 percent of small business lending that is outside of FBAAAs would be evaluated for the first time in RLAAAs
  - exempts banks with branch-based business models (banks with 80 percent or more of retail lending within facility-based assessment areas)
  - increases the loan count thresholds that would trigger RLAAAs (from 100 to 150 closed-end home mortgage loans, and from 250 to 400 small business loans)
- reduces the number of product lines potentially evaluated in RLAAAs: home mortgage loans or small business loans are only evaluated if the specific product line meets the triggering thresholds; other product lines are not evaluated in RLAAAs
- based on agency analysis of 2018–20 CRA historical data, the agencies estimate that the changes described above would reduce by about half the number of large banks that would be required to delineate RLAAAs and the number of RLAAAs that would be created based on prior year lending. The approach would still evaluate banks with significant concentrations of retail loans outside facility-based assessment areas.

### 4. Adds metric and impact factor to evaluate bank CD investments under the CD Financing Test

- adds additional metric to CD financing evaluations, focusing on certain CD investments relative to deposits for banks greater than \$10 billion, to enable examiners to evaluate bank investments under the Low-Income Housing Tax Credit and the New Markets Tax Credit programs. Strong bank performance under the metric would be a basis for positive consideration.
- creates an impact factor to recognize the important affordable housing and community development contributions of Low-Income Housing Tax Credit and New Markets Tax Credit investments

### 5. Provides additional flexibility under the strategic plan option while continuing to meet the credit needs of communities

- clarifies the option for any bank to request evaluation under a strategic plan and provides additional flexibility for banks with nontraditional business models
- strategic plans would need to reflect community input and meaningfully reflect that the bank seeking a plan will continue to meet the credit needs of communities if the plan diverges from the otherwise applicable performance tests

### 6. Addresses feedback on the need to have additional time for banks to implement the new rule

- increases the amount of time for banks to come into compliance with the new requirements (from 12 months to more than 24 months after the rule is adopted and published on the agency websites), balancing industry requests for additional time and the objective of implementing the regulations in a timely manner

### 7. Retains and clarifies the provision on CRA ratings downgrades

- for CRA ratings downgrades, maintains the current standard for “discriminatory or other illegal credit practices” rather than both credit and noncredit practices as proposed

### 8. Ensures consideration of certain small business loans under the economic development category of community development

- for certain loans to small businesses that meet a size and purpose test, allows consideration as a community development loan under economic development in addition to evaluation as a retail loan



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## REGULATORY CALENDAR

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
01/01/26 (most provisions)	Reg. BB	Agencies issue final rule to modernize their implementing regulations for the Community Reinvestment Act
01/01/24	Reg. Z	Agencies announce dollar thresholds for smaller loan exemption from appraisal requirements for higher-priced mortgage loans
01/01/24	Regs. M and Z	Agencies update annual dollar amount thresholds for Regulations M and Z
01/01/24	Regs. C and Z	Consumer Financial Protection Bureau (CFPB) adjusts annual dollar amount thresholds under the Truth in Lending Act and the Home Mortgage Disclosure Act
11/17/23	12 C.F.R. 1090	CFPB issues proposed larger-participants rulemaking for the market for general-use digital consumer payment applications
11/14/23	Reg. II	Federal Reserve proposes to lower the maximum interchange fee a large debit card issuer may charge
10/31/23	12 C.F.R. 1033	CFPB issues rulemaking proposal to implement §1033 of the Dodd–Frank Act
10/30/23	n/a	Agencies issue principles for climate-related financial risk management for large financial institutions
10/12/23	Reg. B	CFPB and Department of Justice issue Joint Statement on Fair Lending and Credit Opportunities for Noncitizen Borrowers Under the Equal Credit Opportunity Act
09/21/23	Reg. V	CFPB begins rulemaking process to regulate consumer reporting of medical debts

## REGULATORY CALENDAR

EFFECTIVE DATE OR PROPOSAL DATE†	IMPLEMENTING REGULATION	REGULATORY CHANGE
09/19/23	Reg. B	CFPB issues Advisory Opinion on adverse action notice requirements for creditors using artificial intelligence
08/29/23	Reg. B	CFPB's Statement on Enforcement and Supervisory Practices Relating to the Small Business Lending Rule Under the Equal Credit Opportunity Act and Regulation B
07/21/23	FHA, Regs. Z and B	Proposed Interagency Guidance on Reconsiderations of Value of Residential Real Estate Valuations
07/06/23	Reg. B	CFPB issues annual fair lending report for 2022
06/21/23	Reg. Z	Agencies issue proposed rulemaking on quality control standards for automated valuation models
05/11/23	Reg. Z	CFPB issues proposed rule for residential property assessed clean energy financing
04/03/23	UDAAP	CFPB issues policy statement on prohibition of abusive acts or practices
**	Reg. B	CFPB's final rule under §1071 of the Dodd–Frank Act requiring lenders to collect small business loan data
03/29/23	Reg. Z	CFPB issues rulemaking proposal to revise safe-harbor credit card late fees

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

\*\* On October 26, 2023, a federal district court in Texas temporarily suspended enforcement of the rule nationwide.

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## 2024 CALENDAR OF EVENTS

March 4–7, 2024	<b>2024 National Interagency Community Reinvestment Conference</b> Oregon Convention Center Portland, OR
March 15, 2024	<b>Consumer Research Symposium</b> FDIC Arlington, VA
April 18–19, 2024	<b>Inaugural Fintech and Financial Institutions Research Conference</b> Federal Reserve Bank of Philadelphia Philadelphia, PA
May 2–3, 2024	<b>2024 CFPB Research Conference</b> CFPB Washington, D.C.
May 15–16, 2024	<b>The Mortgage Market Research Conference</b> Federal Reserve Bank of Philadelphia Philadelphia, PA
June 11–14, 2024	<b>American Bankers Association Annual Risk and Compliance Conference</b> Seattle Convention Center Seattle, WA

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# COMPLIANCE INSIGHTS

## Top-of-Mind Compliance Issues for Financial Institutions in 2024

*By Carol Beaumier and Bernadine Reese*

*In the ever-expanding landscape of financial services regulation, there are signs that the standard for compliance is shifting from a technical evaluation of how a financial institution implements laws and regulations to a more outcomes-based assessment that considers whether a financial institution has taken sufficient, proactive actions to prevent harm. With this shift comes the need for financial institutions, their boards and senior management, and their Compliance functions to have a clear and complete view of immediate and emerging risks and to ensure they have processes and controls in place to manage them proactively.*

In years past, we have categorized compliance priorities for financial institutions under headings such as Uncertainty, Broader Risk Mandates and Traditional Compliance Issues. Today, it seems uncertainty and the disruption it brings have become the norm, as has Compliance's role in many other areas of risk management. This has resulted in the need for Compliance departments to self-evaluate continually whether they are optimizing their operations to manage current and expected challenges. In turn, this has prompted us to group what we see as the 2024 top-of-mind compliance issues into two broad categories: External and Internal.

# Compliance Priorities — 2024

External	Still Trending	New in 2024
1. Artificial Intelligence (AI)	✓	
2. Consumer Outcomes		✓
3. Operational Resilience	✓	
4. Conduct and Culture		✓
5. Sanctions	✓	
6. Supply Chain		✓
7. Crypto Fallout		✓
8. Convergence of Financial Crime	✓	
9. ESG	✓	
Internal		
10. Compliance Risk Assessment		✓
11. Horizon Scanning		✓
12. Risk in Change		✓
13. Digital Risk	✓	
14. Compliance Monitoring and Assurance		✓
15. Resourcing		✓

We have expanded our list this year from 10 to 15 priorities. There is no special significance to this number, just a nod to the fact that maintaining effective compliance programs at financial institutions isn't getting any easier. Additionally, as we have noted previously, our list is not intended to be all-inclusive. The priorities are not organized in any rank order and do not affect all types of financial institutions to the same degree, and aspects of the priorities clearly overlap.

We noted a LinkedIn post recently where a former compliance officer said he was not going to read any "top lists" this year unless the authors include the predictions they made in 2023 and prove they stood the test of time.<sup>1</sup> Fair enough, we say. So, before we elaborate on our 2024 expectations, we will revisit briefly our 2023 list.

In our list of the top 15 priorities for 2024, we have also indicated whether the priority is *still* trending, i.e., whether it appeared on last year's list or is new to the list this year. In several instances, "new" to the list does not mean the issue has not been a priority in the past but indicates that recent developments have moved it up the list for 2024.

<sup>1</sup> "It's tough to make predictions, especially about the future," Jim Richards, *Anti-money Laundering — WTF?*, November 29, 2023: <https://antimoneylaundering.wtf/f/%E2%80%9Cit%E2%80%99s-tough-to-make-predictions-especially-about-the-future%E2%80%9D>.



## 2023 Revisited

Entering 2023, we expected the following to be priorities for financial institutions globally: financial stress; geopolitical tension; people challenges; regulatory hedging and blocking; emerging technology; data; environmental, social and governance (ESG issues); financial crime; privacy; and cybersecurity.<sup>2</sup> With the benefit of hindsight, we might have placed more emphasis on cryptocurrency, although it was mentioned in the context of regulatory hedging and blocking as well as financial crime. That aside, we think our 2023 list was on target and we stand behind our predictions. Several of the 2023 issues carry over to our 2024 list, some as they appeared in 2023 and others, as explained in the sections below, using different terminology as issues have continued to evolve.

## 2024 External Issues

Whether in the context of back-office operations, customer-facing services, risk management or compliance, no issue garners more attention today than **AI**. While animated debate continues among governments, advocates for the responsible use of technology, and the financial services industry — including participants at the Bletchley Park AI Safety Summit in November 2023 — as to how AI should be regulated, financial institutions are grappling with the opportunities and risks of AI. Along with board members and senior executives, compliance officers need to understand quickly the technology to manage the compliance risks it poses. Compliance officers will play a key role in determining the controls needed in business and operations applications of AI to meet local regulatory requirements as well as data governance and model requirements. They would also be well-advised, as discussed further below, to consider how AI can be used to improve the efficiency and effectiveness of the Compliance function.




Compliance officers will play a key role in determining the controls needed in business and operations applications of AI to meet local regulatory requirements as well as data governance and model requirements.

<sup>2</sup> “The evolving complexity of financial institution compliance: Top compliance priorities for 2023,” *Compliance Insights*, Protiviti, December 2023: [www.protiviti.com/sites/default/files/2023-07/newsletter-top-compliance-priorities-for-2023-protiviti.pdf](http://www.protiviti.com/sites/default/files/2023-07/newsletter-top-compliance-priorities-for-2023-protiviti.pdf).


Consumer protection measures are the mainstay of retail compliance. Therefore, compliance officers will be tracking the rollout of consumer protection measures in the U.S., Australia, Europe, Hong Kong, Singapore and other jurisdictions. After trying for more than 20 years, with limited success, to ensure that financial institutions “treat customers fairly” and then identify and manage “conduct risk” relating to customer interactions, the UK’s Financial Conduct Authority has received new powers (through the Consumer Duty) to regulate **customer outcomes** — ensuring that regulated firms, effective July 2023, must act to deliver good customer outcomes for retail customers (including vulnerable customers). This regulation raises the bar for UK financial institutions. Another recent example of outcomes-based regulation comes from the Australian Securities and Investments Commission (ASIC), which has fined multiple financial services firms for poor customer outcomes, including misleading statements and financial promotions, unfair contract terms, overcharging customers, and other poor pricing practices.

**Operational resilience**, with cybersecurity as one of its linchpins, continues to be high on regulators’ agendas globally, although regulatory approaches and expectations may differ by country. Given the interconnectedness of the financial services industry, there is increasing focus on dependencies on critical third parties, outsource arrangements and vendors that play critical roles in delivering important business services and on which financial institutions rely to achieve resilience. Being able to monitor and oversee such third parties, which may number in the hundreds for individual firms, is a key area of focus. In July 2023, U.S. prudential regulators issued their long-awaited *Interagency Guidance on Third Party Relationships: Risk Management*, and in December 2023 the Financial Stability Board released a tool kit for enhancing third-party risk management and oversight; these are just two examples of recent regulatory guidance. While operational resilience programs are generally not managed by the Compliance function, Compliance nonetheless will continue to play a key role in ensuring that all regulatory requirements and standards are met.



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**Conduct and culture** — and the increasing impacts they have on regulatory risk — will be a focus for compliance officers in 2024. Whether it is the regulation of non-financial misconduct or the proposed mandatory disclosures to encourage diversity and inclusion in the UK, or publication of a consultative *Culture and Behaviour Risk Guideline* by Canada’s Office of the Superintendent of Financial Institutions (OSFI)<sup>3</sup> outlining outcomes for which firms are accountable and emphasizing how a sound culture and proactive management of behavioral risks contribute to good outcomes, an organization’s culture has never been more important. Compliance officers know that sustainable and embedded implementation of regulatory requirements is effective only when reinforced by senior management action and a supportive company culture. The many impacts of culture on financial misconduct and poor customer outcomes are increasing regulatory focus on board effectiveness, governance, senior management accountability, and remuneration and incentivization. In Hong Kong, regulators have introduced new requirements for remuneration design and claw backs, and in Australia, financial services firms also need to evidence a board-level view on risk culture.<sup>4</sup> In examples of “practice what you preach,” two U.S. regulators, the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC), are currently under scrutiny for culture and conduct lapses related to, respectively, ignoring a hostile work environment and deficient vetting of a senior-level hire.



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With a slowing, but not stopping, issuance of Western **sanctions** against Russia, industry and regulatory attention has shifted from implementing the sanctions to evasion and enforcement. Regulators across the globe have published studies and guidance on evasion techniques, such as the May 2023 joint release by the U.S. Financial Crimes Enforcement Network (FinCEN) and the U.S. Bureau of Industry and Security (BIS), as well as the UK National Crime Agency’s (NCA) November 2023 warning on the use of gold to evade Russian sanctions. Contrary to what we have witnessed in the past, where it has taken regulators and other enforcement bodies years to build and report cases of sanction evasion, we are already seeing a steady stream of reporting of


<sup>3</sup> *Culture and Behaviour Risk Guideline*, Office of the Superintendent of Financial Institutions, Government of Canada, February 2023: [www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/cbrsk\\_dft.aspx](http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/cbrsk_dft.aspx).

<sup>4</sup> *How financial firms can prepare for the 2024 regulatory landscape*, EY, December 2023: [www.ey.com/en\\_gl/banking-capital-markets/how-firms-can-respond-to-the-2024-regulatory-landscape](https://www.ey.com/en_gl/banking-capital-markets/how-firms-can-respond-to-the-2024-regulatory-landscape).

Russian evasion — a clear sign of the importance Western governments are placing on trying to cut off evasion channels.

These cases highlight the need for financial institutions' Sanction Compliance departments to be highly engaged and coordinated with their counterparts in transaction monitoring, trade operations and cyber risk management, among others, in order to identify and report evasion. (More about this is found below in our discussion of the convergence of financial crime.) Financial institutions simultaneously need to consider other lessons learned during the early days of the Russian sanctions and modify and enhance their sanctions compliance programs accordingly. Finally, it must be noted that geopolitical tensions across the globe, including U.S.-China relations and the Middle East conflict (including Iran's potential role), remind us that while much of the sanction attention in the last two years has been on Russia, compliance risk overall is far more pronounced than it has been in recent history and carries with it significant enforcement and reputation risk.

When we consider managing **supply chain** risk, we generally think about manufacturers and retailers and not about financial institutions. Apart from the credit issues that may stem from supply chain disruption, a financial institution's supply chain also presents compliance risks including corruption, fraud, export controls and sanctions, ESG requirements, and labor law anti-human trafficking compliance, among others. This requires financial institutions to make sure they are considering these issues as part of a comprehensive third-party risk management program, and in light of stepped-up constituent and regulatory interest, the latter should include supply chain certification requirements that are required in some jurisdictions.



Compliance risk overall is far more pronounced than it has been in recent history and carries with it significant enforcement and reputation risk.

Who would have thought that — following the conviction of FTX's Sam Bankman-Fried, the multibillion-dollar settlement with Binance and the conviction of its CEO, Changpeng Zhao, amid other crypto industry scandals — there would be optimism about the crypto world? But this is exactly what has happened. The two cases are quite different, of course: The FTX case involves the mishandling of customer funds, while the Binance case is based on alleged money laundering and sanctions violations. With these cases nearly resolved, there is optimism that this chapter of **crypto fallout** is behind us and that investors can now feel more confident that

bad actors will be punished. Crypto prices, in fact, recovered in 2023 following the devastating losses incurred in 2022. The future, however, is not as clear and rosy as some would like to believe. While jurisdictions across the globe (including Japan, Singapore, Hong Kong, Dubai and the UK) continue to welcome cryptocurrency companies and have developed and implemented regulatory regimes to supervise them, the United States remains a bystander, with no defined regulatory regime and where the future of crypto currently depends on the outcome of SEC litigation and on the political will (thus far lacking) for the Congress to act. For now, the disparate national frameworks governing crypto activities will continue to challenge financial institutions and their compliance personnel.

Financial crime has been a perennial issue on our listings of compliance priorities. New anti-money laundering (AML) requirements are never lacking, and recent events, as discussed above, have elevated the focus on sanctions compliance. Beyond these core pillars of financial crime, we are seeing a push toward the **convergence of financial crime** — a view that includes not just AML and sanctions, but also anti-bribery and corruption, fraud, cybercrime, and market abuse, among other areas. We have seen this push before, but progress has been slow and mixed at best. Two factors may now serve as catalysts to develop more integrated financial crime functions: an overarching, global concern with the proliferation of fraud and cybercrime, and the availability of innovative technologies. Compliance officers will be expected to be the architects of these integrated financial crime-focused Compliance functions and should increasingly expect regulators to ask about their plans and progress.



We expect continued focus on the development and implementation of ESG strategies and policies in many countries.


In our June 2023 edition of *Compliance Insights*, we argued for the need for the Chief Compliance Officer (CCO) to step up and play a key role in the adoption of **ESG** strategies. At COP28's Finance Day in December 2023, we saw how the financial sector remains a vital mechanism for initiating and sustaining change. We expect continued focus on the development and implementation of ESG strategies and policies in many countries, although in some the political realities and costs of adopting green and net zero policies are causing less progress than might have been expected from a climate emergency. We expect that regulators will continue to develop and refine disclosure regimes, and the introduction of the first of the Statements from the International Sustainability Standards Board will bring hope that greater global alignment

around disclosure standards and requirements can be achieved. Financial regulators, including those in Europe, the UK, Canada, Japan, Hong Kong and Singapore, will continue to focus on developing and refining climate change stress tests, anti-greenwashing measures and definition of the “S” (social) components, as well as on developing the sustainable finance markets. The planned or expected adoption of reporting and disclosure standards in various jurisdictions, including Europe and the United States, will set further compliance expectations.

## 2024 Internal Issues

Today’s CCO might be forgiven (at least temporarily) if she says she is too busy dealing with everyday fires to think about optimizing the Compliance function. But we all know that not upgrading compliance operations only adds to the view that everything is a firefight. In the following sections, we offer some observations and recommendations for the busy CCO.

No competent CCO would argue with the premise that a **compliance risk assessment** is foundational to building an effective risk management program. Yet often, the process of developing the risk assessment seems to take on more significance than the results, and results may be obsolete by the time the risk assessment is finalized. This is an area ripe for innovation. CCOs would be well-advised to consider how they can use AI to develop a regulatory inventory (the first step in performing a risk assessment) and a risk control library and use technology to automate the risk assessment process to make it dynamic rather than static.

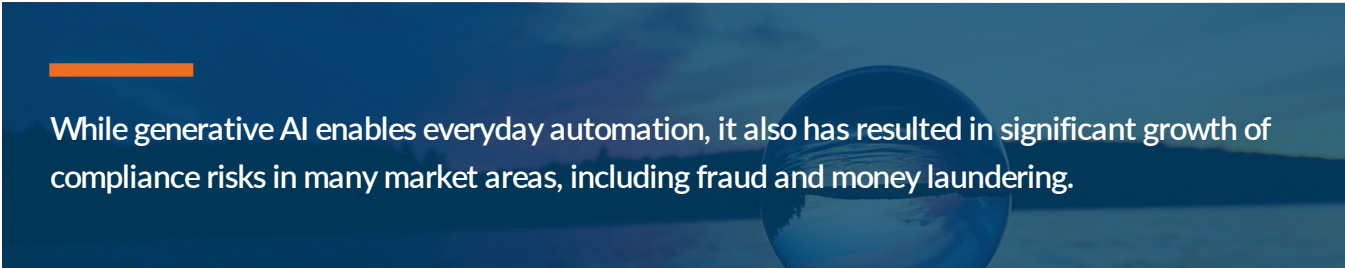


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For a risk assessment to be dynamic and for financial institutions to demonstrate to their regulators that they are attuned to and proactively considering the impact of emerging compliance risks, financial institutions need a **horizon scanning** function. This function uses a variety of sources to perform a systematic examination of new or potential areas of compliance risk, effectively communicates the expected impacts, and keeps the appropriate people in the institution informed of developments to allow for better preparedness and implementation. In smaller, less complex financial institutions, the CCO may be able to carry out this function, but in larger, more complex and multinational institutions, horizon scanning is a full-time job that may require a team of people to be effective.

Given the dynamics of the regulatory environment, a CCO, or a senior member of her team, also needs to be an expert at **risk in change** — the process of guiding organizational change from design and preparation through implementation. The costs of poorly managed change are many: missed deadlines, rework, increased costs, flawed implementation, and — in the case of regulatory requirements — potential violations of law, financial penalties and other regulatory actions. Change itself is a risk to financial institutions, and being an effective change agent is a core competency of a CCO. This requires the CCO to understand the change culture (including pain points and other obstacles) within her institution, develop a change management framework that works with the culture, continually prioritize the change issues facing the institution, and champion the change culture.

Risk in change extends beyond the implementation of new requirements — it also has a direct impact on issues management. While compliance issues may arise anywhere in an institution, the Compliance function has final sign-off (or, in some instances, penultimate sign-off before review by internal audit) on whether compliance issues have been appropriately resolved. This requires that Compliance identify all open issues, effectively challenge and sign-off on remediation plans, approve related communications (e.g., to customers or regulators), monitor implementation status, and confirm that the resolution satisfies regulatory requirements and expectations. It may also require Compliance to conduct training on new or revised processes and develop and implement monitoring regimes to protect against recurrence. How well institutions manage the adoption of new requirements and remediate open issues can significantly impact a regulator’s assessment of the Compliance function and the effectiveness of the CCO.

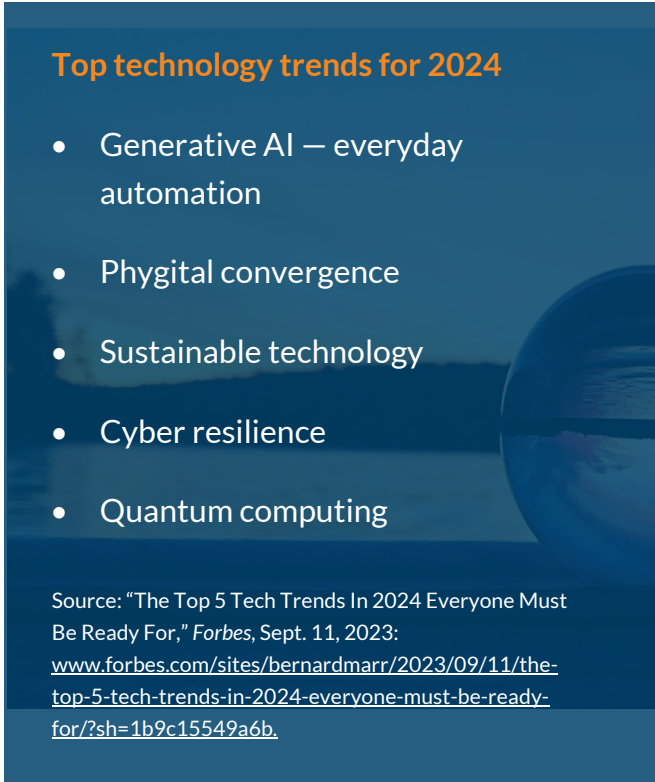


While generative AI enables everyday automation, it also has resulted in significant growth of compliance risks in many market areas, including fraud and money laundering.

Over the past few years, we have consistently called out **digital risk** arising from emerging technology as a key focus area for CCOs. Prior to the launch of ChatGPT in November 2022, it would have been hard to foresee the extent to which technologies such as AI would be at the top of a CCO’s agenda barely a year later. While generative AI enables everyday automation, it also has resulted in significant growth of compliance risks in many market areas, including fraud and

money laundering. Last year we referenced Forbes' Top Technology Trends in 2023;<sup>5</sup> the 2024 Forbes list includes generative AI, sustainable technology and cyber resilience. (See sidebar.)

While some technology trends (such as cyber resilience) are not new, the rapid deployment of AI and advanced technologies is increasing the risks in these areas. Constant review and updating of cyber defenses is required and resilience in the face of a cyberattack becomes critical. The 2024 trends also include “phygital,” which refers to the greater alignment and interaction of the physical and digital worlds. For example, as virtual reality and augmented reality become more mainstream, CCOs may consider how this technology can help with training. Digital twin usage has already become more widespread in operational resilience arrangements. Similarly, widespread adoption of advanced technology in society and financial services will need to be underpinned by quantum computing speeds and capacities.



**Top technology trends for 2024**

- Generative AI — everyday automation
- Phygital convergence
- Sustainable technology
- Cyber resilience
- Quantum computing

Source: “The Top 5 Tech Trends In 2024 Everyone Must Be Ready For,” *Forbes*, Sept. 11, 2023:  
[www.forbes.com/sites/bernardmarr/2023/09/11/the-top-5-tech-trends-in-2024-everyone-must-be-ready-for/?sh=1b9c15549a6b](https://www.forbes.com/sites/bernardmarr/2023/09/11/the-top-5-tech-trends-in-2024-everyone-must-be-ready-for/?sh=1b9c15549a6b).


With more “next gen” technology now available, **compliance monitoring and assurance** is undergoing a transformation from an “optional” activity to one that adds value and insights. The focus on outcomes rather than process in areas such as consumer protection is leading to a focus on outcomes testing by the monitoring function. CCOs who focus monitoring on issues they have assessed as higher risk, use appropriate technology to automate monitoring controls, bring in expertise to conduct thematic reviews, and align their monitoring with the controls testing in the first line and internal audit reviews will be well-placed in managing the firm’s regulatory risk.

<sup>5</sup> The 2023 list included (1) Artificial intelligence and machine learning, (2) Metaverse, (3) Use of digital twin technology in a digitally editable world, (4) Widespread adoption of DeFi, and (5) Increasing connectedness in the IoT.



Last but never least is **resourcing**. There is an oft-repeated pattern in Compliance functions: Ramp up when regulators criticize the compliance efforts of the financial institution, and ramp down as soon as the previously identified issues have been resolved. While a Compliance function should not staff for crisis mode, fluctuations in resourcing are not the solution either. Leveraging technology to the extent feasible, Compliance functions should be staffed with a core team of skilled and experienced individuals to meet business-as-usual needs. The team also should have the capacity to scale by borrowing personnel from other departments and/or engaging consultants or temporary staff when the situation demands it.

This, of course, is not as simple as it sounds. First, there needs to be agreement on what the business-as-usual needs are given the expanding role of Compliance as we have described it here and in previous publications. Next, there needs to be recognition that the current staff may need to be upskilled to meet current and future challenges. Finally, depending on a flex model requires pre-planning to identify the resources that will be added as needed. And for anyone who believes that innovative technologies will do away with the need for compliance personnel, we say, “Not a chance.” The more innovative technologies like AI blur the distinction between reality and fantasy, the more important the human touch becomes to ensure institutions satisfy not only the letter but also the spirit of laws and regulations.



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## About the authors

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**Bernadine Reese** is a managing director in Protiviti's Risk and Compliance practice. Based in London, Reese joined Protiviti in 2007 from KPMG's Regulatory Services practice. Reese has more than 30 years' experience working with a variety of financial services clients to enhance their business performance by successfully implementing risk, compliance and governance change and optimizing their risk and compliance arrangements. She is a Certified Climate Risk Professional.

## About Protiviti's Compliance Risk Management Practice

There's a better way to manage the burden of regulatory compliance. Imagine if functions were aligned to business objectives, processes were optimized, and procedures were automated and enabled by data and technology. Regulatory requirements would be met with efficiency. Controls become predictive instead of reactive. Employees derive more value from their roles. The business can take comfort that their reputation is protected, allowing for greater focus on growth and innovation.

Protiviti helps organizations integrate compliance into agile risk management teams, leverage analytics for forward-looking, predictive controls, apply regulatory compliance expertise and utilize automated workflow tools for more efficient remediation of compliance enforcement actions or issues, translate customer and compliance needs into design requirements for new products or services, and establish routines for monitoring regulatory compliance performance.

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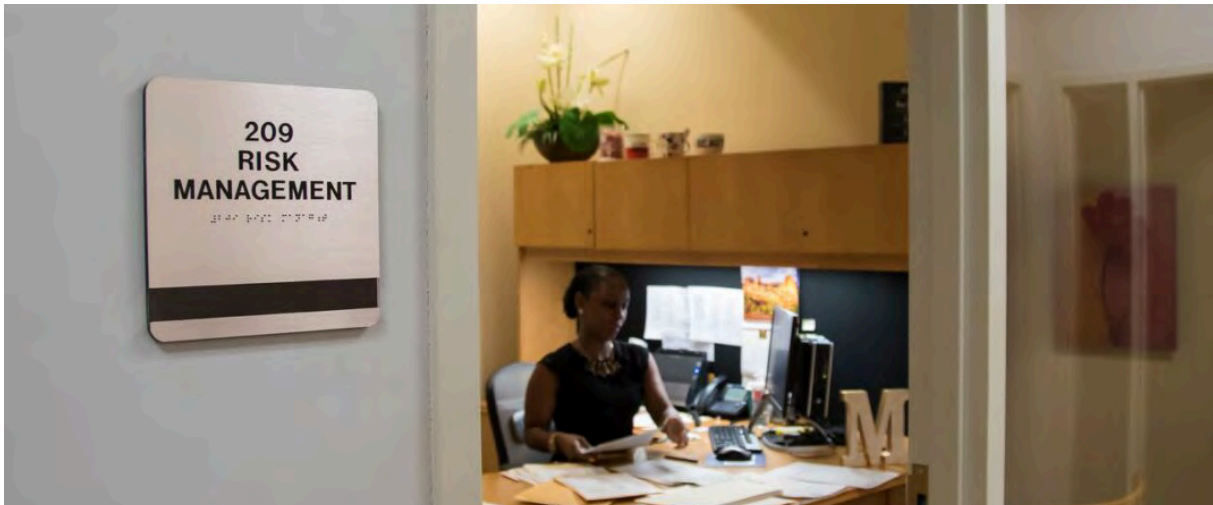


Photo by Karen Martin

## | Top bank risks for 2024

ON JANUARY 3, 2024

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By John Hintze

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Hardly a year goes by without major events, whether geopolitical, financial, or something completely unanticipated like a global pandemic, that dramatically impact financial markets, the economy, and banks. Last year was no exception, and 2024 is on track to remain a challenging environment — even without any completely unexpected surprises.

The collapse of Silicon Valley Bank and two other large banks in early 2023 put a spotlight on interest rate risk management. The suddenness and severity of their fall ramped up investors' and regulators' scrutiny of banks across the sector and the risks they face, likely a factor in the drumming bank stocks have taken since. Meanwhile, banks were already dealing with significant risks, including cyber attacks and fraud, depositors shifting funds to higher-return investments, and the effects of the pandemic on both their investment and loan portfolios. Rather than finding resolutions, those risks only seemed to grow last year and become more complex.

That trend is clearly continuing into 2024, with risks such as cybersecurity amplified by the rapid adoption of artificial intelligence and in particular generative AI technologies. The greatest worry expressed by bankers and experts, however, appears to be onslaught of regulatory changes. Even those not going into effect well after 2024 are likely to keep bankers up at night in the year ahead as they analyze the potential operational and strategic impacts and how to address them. "The biggest



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stress is what's on the horizon, more than what bankers are dealing with immediately," says ABA EVP Ginny O'Neill.

### **Banks face a barrage of regulatory scrutiny and rules**

The regulatory rules and issues just keep layering on top of each other, with little apparent coordination among the various regulators or consideration about what their combined impact will be. In the meantime, banks must prepare systems and train staff to comply with the requirements — and given the complexity, even prepared banks can face compliance risk.

"From the final Community Reinvestment Act rules to Rule 1071 and various other CFPB-related rules and considerations, banks will need to continue to invest a significant amount of time and talent to ensure they meet their compliance obligations," says Kristina Schaefer, CRCM, CERP, general counsel, chief risk officer and chief administrative officer at First Bank and Trust, a \$1.7 billion-asset institution headquartered in Sioux Falls.

Among the most significant, even for small banks, is Dodd-Frank Act Section 1071, final rules for which the CFPB finalized last March. It essentially levies onto banks' small business lending the type of reporting, data collection and hygiene currently required for consumer credit. (As previously reported, banks with more than 2,500 covered credit transactions would have faced a tight compliance date of Oct. 1 of this year, and those with as few as 100 transactions by Jan. 1, 2026, but due to a lawsuit brought by ABA and the Texas Bankers Association, enforcement of the final rule is suspended until the Supreme Court rules on a challenge to the constitutionality of the CFPB's funding, and the new compliance deadlines will be stretch out by that amount of time.)

Nevertheless, banks will have plenty to do this year, including preparing their systems, software and other changes necessary to be compliant. Small business lending typically occurs in different divisions in a bank, ranging from Small Business Association loans to equipment financing to credit cards, and banks will have to collect normalized data to report annually to the CFPB. The rule "can dramatically reshape small business lending, because institutions may not be able to price the risk

like they do today,” explains David Kelly, CRCM, CERP, chief risk officer at \$28 billion-asset FirstBank, headquartered in Lakewood, Colorado.

Section 1071 requirements have also been incorporated into the Community Reinvestment Act final rule, which regulators updated in October in a 1,500-page final rule. Kelly says the new CRA requirements may be problematic for smaller banks operating in more confined geographical markets, since pushing to reach certain metrics may lead to greater credit risk. Plus, banks are increasingly competing against nonbank credit providers not subject to the rule. “When only banks have to hit certain metrics, it can create risk in the banking sector,” Kelly says.

Also on the horizon is the banking regulators’ Basel III “endgame” proposal issued last July. In a September report, EY says it “will fundamentally alter how banks with over \$100 billion or more of assets approach risk-based regulatory capital and capital management.” The proposal will likely increase the banks’ risk-weighted assets, the report said, and require smaller ones to enhance their risk data and technology capabilities and controls.

### **Elevated rates present a range of risks**

More urgently, the Federal Reserve has extended more than \$100 billion in loans to mostly regional banks through its post-SVB Bank Term Funding Program, and those banks must either repay the loans by March 11 if the program is not extended, says George Goncalves, head of U.S. macro strategy at MUFG Securities Americas.

“It boils down to another manifestation of interest-rate risk, which has really held back the regional banks,” Goncalves says, pointing to ongoing higher interest rates increasing deposit costs and squeezing bank margins, as well as potentially resulting in more losses if fixed-income investments are not kept in held-to-maturity accounts.

In addition, there’s been significant interest-rate volatility over the past few years. Matthew Tevis, managing partner and head of Chatham Financial’s financial institutions team, says recent moves of

20 basis points or more in the 10-year Treasury bond's rate are not unusual. "Our balance-sheet risk management team, which is now helping banks manage their asset-liability risk, is having a record year," he says. He adds that business picked up significantly soon after March's regional bank failures and has gained momentum as clients seek to protect themselves against different scenarios, often using pay-fixed swaps either to extend liabilities or shorten asset duration.

The higher cost of deposits, in some cases prompting banks to let them run off, has resulted in increasing challenges that can create business risks. Tevis notes, for example, a client that had originated a sizable loan and faced difficulties in finding bank participants to share in the credit. "Even during the crisis we saw last March and April and into May, we didn't hear as much about banks slowing down loan originations because of liquidity," Tevis says.

### **Credit issues are starting to emerge**

Just as banks' margins are tightening, their loans are showing signs of deterioration. ABA's Economic Advisory Committee, made up of chief economists from North America's largest banks, expects credit conditions to worsen in the coming months. Delinquencies for both consumer and commercial debt remain relatively low, but they are rising. That's to be expected in an economy facing headwinds, but a few commercial real estate sectors are facing more fundamental changes. Malls and other retail shopping outlets, for example, have long been under pressure as consumers increasingly shop online, and remote work during the pandemic accelerated that trend. Even more worrisome for banks are office buildings high vacancy rates.

Cristian deRitis, deputy chief economist at Moody's Analytics, says about \$1.5 trillion in CRE loans are maturing over the next few years. If depressed rental incomes don't justify refinancing loans, banks will have to decide whether to pursue foreclosures or modifications in hopes of a recovery down the road. "I expect prices of office buildings to fall around 30 percent from their peak over the next three to four years, some much more," deRitis says.

Banks' third-quarter earnings reports indicated the CRE repricing process is picking up steam. For example, \$13.5 billion-asset OceanFirst Bank attributed its net income dropping to \$19.7 million from the second quarter's \$26.8 billion to higher deposit costs and writing down of a nonperforming CRE loan secured by a Manhattan office building, to \$8.8 million from \$17 million. Meanwhile, PNC Financial Services, with nearly \$560 billion in assets, reported nonperforming loans increasing by \$210 million, or 11 percent, "primarily due to an increase in commercial real estate nonperforming loans, partially offset by lower consumer nonperforming loans."

While the largest banks carry the bulk of CRE loans, regionals are likely to be most affected by CRE credit deteriorating. "It's big business for very large banks, but percentage-wise it's relatively small," says Adrian Ungureanu, managing principal at management consultancy Capco. "For community and regional banks, however, the portion of overall CRE risk they hold is smaller than the big banks, but as a portion of their businesses it's higher."

### **Fraud supercharged by AI**

Elevated deposit rates will push banks to grow fee income and cut costs, says Mary Clouthier, CRCM, CERP, the chief risk officer at Cornerstone Capital Bank in Texas, but overdoing it can create its own risks. "Wholesale cost-cutting efforts should not cut into investments in technology and IT talent that are warranted both to protect the bank and grow its business," she explains.

Cybersecurity continues to rank as a top risk across corporate America, and the rapid commercialization of AI has provided cybercriminals with a more effective tool both to penetrate banks' systems and to perpetrate scams. "We have seen first-hand several scams involving phone calls that are using voices created by this technology,"



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Schaefer says, in a “much more realistic — and sometimes terrifying — version of the ‘grandparents scam,’” in which the perpetrator usually impersonates a family member to ask for financial assistance or get information.

ABA EVP Paul Benda says check fraud remains a major risk for banks, but top-of-mind is the weaponization of widely available generative AI to accelerate fraudulent schemes, whether to fool voice or knowledge-based authentication procedures or to draft and send out phishing emails at scale. “There’s fear now that if the conflict between Israel and Hamas spreads wider, state actors like Iran could pursue banking sector attacks, which it has done in the past,” Benda says.

Demand for expertise to fortify a bank’s systems against cyberattacks has become increasingly hard to find and expensive, and AI is adding another complication. “Somebody might look really good on paper, but they may use AI tools to fake it,” even potentially when responding to a question during a Zoom interview, Kelly says. He adds that AI, which has long been used as a tool in compliance and risk management, has its pluses, and his bank is looking at generative AI to speed up the coding process to improve its systems, as well as to generate letters and communications to clients much more quickly.

### **Geopolitical shocks from out of the blue**

Nobody predicted COVID-19 or the extent of last year’s bank upheaval, so it’s unsurprising that bankers are worried about the risks in 2024 that nobody expects.

**Directory to help banks of all sizes resolve check fraud claims as efficiently as possible. The directory provides contact information for banks needing to file a check warranty breach claim with another financial institution. To access the directory, your bank must participate by providing its fraud contacts. The more banks that participate in the directory, the more helpful it will be to the industry. Learn more and join [here](#).**

Kelly at FirstBank says that “first and foremost” he is focused on where the economy is headed and the factors that could impact it, such as the Fed raising rates and taking other actions to reduce liquidity in the economy. “This is a very interesting time in the economic cycle, and it’s unclear whether there will be an economic soft or hard landing, and if it’s the latter what steps can be taken to reverse it,” Kelly explains.

The MUFG macro strategy team thinks the Federal Reserve is likely to decouple from other central banks and start to lower rates as the economy slows, Goncalves says. If other central banks do not follow its lead, he added, that could potentially divert foreign capital away from the U.S. and thus reducing capital coming into the broader U.S. financial system, keeping the cost of capital high for regional and community banks. “That might crowd out lending activity in the U.S.,” Goncalves says.

Goncalves adds that inflation tends to mask companies’ issues because everybody can raise prices at the same time, but when inflation falls, only the stronger brands and companies will maintain market share. “So we would probably see delinquencies and defaults pick up.”

Perhaps harder to hedge, but especially relevant today, are extreme risks that could emerge from the wars in Ukraine and Gaza, tensions with China or, as is often the case with what amount to catastrophic events, from completely unexpected corners. “All three banking regulators have called out geopolitical risk management,” says Ungureanu. “Even community banks are expected to have a framework in place geopolitical risk, whether domestic or international.”

*John Hintze is a frequent contributor to ABA Banking Journal.*

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# CFPB Bans Excessive Credit Card Late Fees, Lowers Typical Fee from \$32 to \$8

*Final rule closes 2010 loophole exploited by credit card giants*

MAR 05, 2024

**WASHINGTON, D.C.** – The Consumer Financial Protection Bureau (CFPB) finalized a rule today to cut excessive credit card late fees by closing a loophole exploited by large card issuers. The rule will curb fees that cost American families more than \$14 billion a year. The CFPB estimates that American families will save more than \$10 billion in late fees annually once the final rule goes into effect by reducing the typical fee from \$32 to \$8. This will be an average savings of \$220 per year for the more than 45 million people who are charged late fees.

“For over a decade, credit card giants have been exploiting a loophole to harvest billions of dollars in junk fees from American consumers,” said CFPB Director Rohit Chopra. “Today’s rule ends the era of big credit card companies hiding behind the

excuse of inflation when they hike fees on borrowers and boost their own bottom lines.

Concerned that credit card companies were building a business model on penalties, fee harvesting, and bait-and-switch tactics, Congress passed the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act). The law banned credit card companies from charging excessive penalty fees and established clearer disclosures and consumer protections.

In 2010, the Federal Reserve Board of Governors voted to issue a regulation implementing the CARD Act, which made clear that banks could only charge fees that recover the bank's costs associated with late payment. However, the rule included an immunity provision that allowed credit card companies to sidestep accountability if they charged no more than \$25 for the first late payment, and \$35 for subsequent late payments, with both amounts to be adjusted for inflation each year. Those amounts have ballooned to \$30 and \$41, even as credit card companies have moved to cheaper, digital business processes. Congress transferred authority for administering CARD Act rules from the Fed to the CFPB.

After a thorough review of market data related to the 2010 immunity provision, the CFPB's final rule adopts a lower threshold of \$8 and ends automatic inflation adjustments for that amount for issuers that have 1 million or more open accounts.

The CFPB [has found](https://www.consumerfinance.gov/about-us/newsroom/cfpb-report-finds-credit-card-companies-charged-consumers-record-high-130-billion-in-interest-and-fees-in-2022/) (cfpb.gov/about-us/newsroom/cfpb-report-finds-credit-card-companies-charged-consumers-record-high-130-billion-in-interest-and-fees-in-2022/) that since 2010, issuers have generally been charging consumers more in credit card late fees each year—growing to over \$14 billion in 2022, and representing more than 10 percent of the \$130 billion issuers charged consumers in interest and fees. Late fees are layered on top of many other punitive measures credit card companies impose on consumers who miss payments, including extra interest charges, loss of their grace period, negative credit reporting, reductions in their credit limit, and a higher interest rate on future purchases. The average late fee for major issuers has steadily ticked up since the passage of the CARD Act, going from

\$23 at the end of 2010 to \$32 in 2022. For some large credit card companies, late fees are a major driver of their profit model.

The CFPB's final rule applies to the largest credit card issuers, those with more than 1 million open accounts. These companies account for more than 95% of total outstanding credit card balances. CFPB data shows that smaller issuers tend to charge lower rates and fees to their borrowers, while the vast majority of the largest issuers charge close to the maximum allowable late fee amount. Today's final rule:

- **Lowers the immunity provision dollar amount for late fees to \$8:** Based on data analyzed by the CFPB, a late fee of \$8 would be sufficient for larger card issuers, on average, to cover collection costs incurred as a result of late payments.
- **Ends abuse of the automatic annual inflation adjustment:** The CFPB found that many issuers hiked their late fees in lockstep each year without evidence of increased costs. The CFPB's final rule eliminates the automatic annual inflation adjustment for the \$8 late fee threshold. This adjustment was added by the Federal Reserve Board and is not required by law. The CFPB will instead monitor market conditions and adjust the \$8 late fee immunity threshold as necessary.
- **Requires credit card issuers to show their math:** Larger card issuers will be able to charge fees above the threshold so long as they can prove the higher fee is necessary to cover their actual collection costs.

The rule does not change the credit card issuer's ability to raise interest rates, reduce credit lines, and take other actions to deter consumers from paying late. In fact, the rule would increase the desire for credit card companies to facilitate on-time payment, since it would lower incentives to build a business model on late fees.

## CFPB's Credit Card Efforts

Today's final rule is part of a continued effort by the CFPB to address problems and foster competition in the \$1 trillion credit card market. The CFPB is working to help consumers find lower interest rates, as consumers paid a record-high \$130 billion in credit card interest and fees in 2022, and the average cardholder carries a balance of over \$5,000.

A recent CFPB report found that [increases in APR margin charged by the largest issuers](https://cfpb.gov/about-us/blog/credit-card-interest-rate-margins-at-all-time-high/) (cfpb.gov/about-us/blog/credit-card-interest-rate-margins-at-all-time-high/) generated around \$25 billion in additional interest revenue in 2023. Data submitted to the CFPB by credit card companies shows that [small banks and credit unions offer significantly lower rates](https://cfpb.gov/data-research/research-reports/credit-card-data-small-issuers-offer-lower-rates/) (cfpb.gov/data-research/research-reports/credit-card-data-small-issuers-offer-lower-rates/), about 8-10 percentage points lower than the largest 25 credit card companies. Last week, the CFPB issued [guidance to rein in rigged comparison-shopping results](https://cfpb.gov/about-us/newsroom/cfpb-issues-guidance-to-rein-in-rigged-comparison-shopping-results-for-credit-cards-and-other-financial-products/) (cfpb.gov/about-us/newsroom/cfpb-issues-guidance-to-rein-in-rigged-comparison-shopping-results-for-credit-cards-and-other-financial-products/) for credit cards and other products, and is developing a consumer-facing tool that, once finished, will give people looking for a new credit card an unbiased way to compare credit card terms and interest rates.

The CFPB has also taken enforcement action against illegal conduct by credit card companies. Recent actions include ordering [Bank of America](https://cfpb.gov/about-us/newsroom/bank-of-america-for-illegally-charging-junk-fees-withholding-credit-card-rewards-opening-fake-accounts/) (cfpb.gov/about-us/newsroom/bank-of-america-for-illegally-charging-junk-fees-withholding-credit-card-rewards-opening-fake-accounts/) to pay a \$30 million fine and repay tens of millions of dollars to consumers for illegal conduct including withholding credit card reward bonuses the company explicitly promised and opening unauthorized accounts. The CFPB also ordered [Citizens Bank](https://cfpb.gov/about-us/newsroom/cfpb-action-require-citizens-bank-pay-9-million-unlawful-credit-card-servicing/) (cfpb.gov/about-us/newsroom/cfpb-action-require-citizens-bank-pay-9-million-unlawful-credit-card-servicing/) to pay a \$9 million fine for failing to give refunds to consumers who reported fraud or billing errors, and ordered [Citibank](https://cfpb.gov/about-us/newsroom/cfpb-orders-citi-to-pay-25-9-million-for-intentional-illegal-discrimination-against-armenian-americans/) (cfpb.gov/about-us/newsroom/cfpb-orders-citi-to-pay-25-9-million-for-intentional-illegal-discrimination-against-armenian-americans/) to pay \$25.9 million for intentional, illegal discrimination against credit card applicants the bank identified as Armenian American.

[Read the text of today's final rule. \(cfpb.gov/rules-policy/final-rules/credit-card-penalty-fees-final-rule/\)](https://cfpb.gov/rules-policy/final-rules/credit-card-penalty-fees-final-rule/)

The effective date of the final rule will be 60 days after publication of the rule in the Federal Register.

Consumers can submit complaints about financial products or services by visiting the [CFPB's website \(cfpb.gov/complaint/\)](https://cfpb.gov/complaint/) or by calling [\(855\) 411-CFPB \(2372\)](tel:855411CFPB2372).

Employees of companies who they believe their company has violated federal consumer financial laws are encouraged to send information about what they know to [whistleblower@cfpb.gov](mailto:whistleblower@cfpb.gov).

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*The Consumer Financial Protection Bureau 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. For more information, visit [www.consumerfinance.gov](http://www.consumerfinance.gov) (<http://www.consumerfinance.gov/>).*

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# CFPB Finalizes Significant Restrictions on Credit Card Late Fees

[Blog](#) Consumer Financial Services Review

**Mayer Brown**

**USA** | March 6 2024

On March 5, the CFPB issued a final rule that would significantly reduce late fees that may be charged on consumer credit card accounts from \$30 or more to \$8 in most cases. A proposed rule on this subject matter was issued February 1, 2023, and the credit card industry has paid close attention to the rulemaking process since.

The final rule amends provisions of Regulation Z, implementing the Truth in Lending Act, related to permissible penalty fees—including late fees, NSF fees, returned payment fees, etc.—that a card issuer may impose on consumers who violate the terms of a credit card account subject to the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the “CARD Act”).

Under current law, card issuers may impose penalty fees not exceeding safe harbor values of \$30 for an initial violation and \$41 for a subsequent violation of the same account requirement within six billing cycles (each dollar amount subject to adjustment annually for inflation). Alternatively, a card issuer may impose fees representing a “reasonable proportion of the total costs incurred by the card issuer” as a result of the violation. In each case, penalty fees may not exceed the dollar value of the violation resulting in the penalty. Establishing penalty fees in excess of the safe harbor values requires substantial analysis and documentation of the relevant costs, such that essentially all card issuers in market today impose fees at or below the safe harbor values.

The final rule resets the safe harbor value for late fees to \$8 for card issuers other than “small card issuers” (those with fewer than 1 million accounts subject to the CARD Act that have an open credit line or an outstanding, non-charged-off balance). It also eliminates automatic inflation adjustments for the new safe harbor, and eliminates the distinction between first and subsequent late payments that exists under current law.

New restrictions would apply only to late fees and affect only the safe harbor value for such fees. The rulemaking would not impose new restrictions on other penalty fees (*e.g.*, NSF or returned payment fees), nor would it eliminate the ability for a card issuer to justify a higher late fee based on analysis and documentation of hard costs incurred as a result of late payments.

While the rule as a whole presents material challenges for the credit card industry and likely will be challenged, there are some positive takeaways. First, as noted above, the final rule contains an exemption for “small card issuers” that was not present in the proposal. Second, the final rule does not contain a separate restriction included in the proposal that would have limited late fees to 25% of the required minimum payment that was late, notwithstanding the safe harbor values. Finally, while delayed over a year from their typical cadence and unlikely to



offset the pain imposed by late fee reductions, the final rule makes the inflation adjustments for other penalty fee types for the first time since January 1, 2022, increasing the safe harbors to \$32/\$43 for a first or subsequent violation.

The final rule will become effective 60 days following publication in the Federal Register. As noted above, litigation is anticipated, and it is possible that the effective date will be stayed, as has been the case for certain other challenged CFPB rulemakings.

**Mayer Brown** - Eric T. Mitzenmacher

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March 7, 2024

# Corporate Transparency Act: Understanding the “Large Operating Company” Exemption

Sean Jensen, Joseph Struble

Clark Hill PLC

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On Jan. 1, the new Corporate Transparency Act (“CTA”) came into effect and imposes reporting obligations on domestic and foreign entities that are within the scope of the definition of “reporting company” under the statute. Entities that do not fall within one of the CTA’s categories of exemptions will be required to file a beneficial ownership information report (“BOI report”) with the U.S. Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”).

Clark Hill [previously published an overview](#) of FinCEN’s final regulations under the CTA, outlining the key regulatory changes and reporting requirements. This alert will provide our clients and contacts that organize their operations through multiple entities with more focused guidance on the large operating company exemption and the subsidiary exemption as they implement the CTA’s reporting requirements across their structures.

While FinCEN estimates that there will be approximately 32 million companies subject to the CTA in 2024, it will largely impact only smaller and unregulated companies. One exemption that is expected to be heavily relied on is the large operating company exemption.

## What Constitutes a Large Operating Company?

To qualify, an entity must meet all three of the following criteria:

1. Employ more than 20 full-time employees in the U.S. (generally working at least 30 service hours per week);
2. Maintain an operating presence at a physical office within the U.S. that is not shared other than with the reporting company’s affiliates; and
3. Have filed a prior year federal income tax return reporting over \$5 million in gross receipts or sales. For entities filing consolidated returns, the entities must use the amount reported on the consolidated return for the group.

### **Scenario #1**

A parent corporation (“Parent”) is the sole owner of two subsidiaries, OpCo and AssetCo (Parent, OpCo, and AssetCo, collectively, the “Group”). Each company has its headquarters in Delaware. Parent, OpCo, and AssetCo each have seven employees and collectively reported more than \$5 million in gross receipts or sales in the previous year’s consolidated tax return.

### **Analysis**

Parent meets the place of business prong (Delaware headquarters) and the \$5 million prong (reported in the previous year’s consolidated tax return). What about the employee prong? Some commentators asked FinCEN if such an entity can aggregate its employees across common ownership for purposes of meeting the 20-plus employee requirement. If so, Parent would collectively have 21 employees across its companies. However, FinCEN stated in [its final rule](#) (“Reporting Rule”) that a company may not consolidate employees across affiliated entities to meet the 20-plus employee prong. The exemption requires that the entity itself employ more than 20 full-time employees in the United States. Thus, not all requirements of the large operating company exemption are met, and Parent must submit a BOI report to FinCEN. OpCo and AssetCo each will also have to submit a BOI report to FinCEN.

### **Scenario #2**

Parent is the sole owner of two subsidiaries, OpCo and AssetCo. Each company has its headquarters in Delaware, and the Group collectively reported more than \$5 million in gross receipts or sales in the previous year’s consolidated tax return. OpCo itself employs 21 employees, while Parent and AssetCo each employ seven employees.

## **Analysis**

Here, the initial facts are similar to Scenario #1, except OpCo now has 21 employees. OpCo meets the place of business prong (Delaware headquarters), the \$5 million prong (reported in previous year’s consolidated tax return), and the 20+ employee prong, and thus meets the large operating company exemption and does not have to file a BOI report with FinCEN. Parent and AssetCo, however, must each still file their own separate BOI reports.

## **The Subsidiary Exemption**

Entities, the ownership interests of which are controlled or wholly owned, directly or indirectly, by certain categories of exempt entities (including the large operating company exemption above) are also exempt from the reporting requirement. Once a parent entity qualifies as an exempt entity by reason of the large operating company exemption, its wholly owned subsidiaries (whether or not corporate entities) generally should also be exempt from the reporting requirement under the subsidiary exemption. For non-wholly owned entities, the analysis of the subsidiary exemption is more complex, as it hinges on whether the equity interests of the entity are directly or indirectly “controlled” by an exempt entity, and neither the CTA nor the Reporting Rule provide a clear definition of “control.”

## **Scenario #3**

Parent is the sole owner of two subsidiaries, OpCo and AssetCo. Each company has its headquarters in Delaware, and the Group collectively reported more than \$5 million in gross receipts or sales in the previous year’s consolidated tax return. While Parent itself employs 21 employees, neither OpCo nor AssetCo currently has any employees.

## Analysis

Here, the initial facts are similar to Scenario #1, except Parent now has 21 employees, while OpCo and AssetCo have no employees of their own. Parent meets the place of business prong (headquarters in Delaware), the \$5 million prong (reported in previous year’s consolidated tax return), and the 20-plus employee requirement, and thus Parent meets the large operating company exemption and does not have to file a BOI report with FinCEN. HoldCo and AssetCo are wholly owned by an exempt entity (Parent meets the large operating company exemption), so each subsidiary qualifies for the subsidiary exemption and neither has to file a BOI report with FinCEN. Note that no one in the Group needs to notify FinCEN that it qualifies for an exemption. Reporting obligations are only triggered when a reporting company is formed, or when an exempt entity ceases to qualify for an exemption.

We will continue to write on this topic to provide insights into this new rule. Our next installment will cover charities and nonprofit entities and how they can stay compliant.

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March 12, 2024

# The Corporate Transparency Act's Impact On Charities and Tax-Exempt Entities

Robin Ferriby, Joseph McCarthy

Clark Hill PLC

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The Corporate Transparency Act (the “CTA”) became effective on Jan. 1. The CTA’s goal is to reduce money laundering and other financial crimes by requiring the reporting of ownership and control information of businesses operating in the United States. Following is a summary of the impact of the CTA on charities and tax-exempt entities.

Nonprofits are exempt from CTA beneficial ownership information reporting requirements. This exclusion applies to all Section 501(c) tax-exempt entities and charitable trusts. If a charity loses its tax-exempt status with the IRS, it has a 180-day grace period during which it is still exempt from CTA filing requirements. If it regains its tax-exempt status in that 180-day period, it will remain CTA-exempt. However, if it does not regain its tax-exempt status in that 180-day grace period, the entity has 30 days to file its beneficial ownership report.

Entities formed by a nonprofit are likely CTA-exempt as well. A single-member LLC or other entity that is controlled or wholly owned, either directly or indirectly, by one or more charities or tax-exempt entities is exempt from the CTA reporting requirement. This subsidiary exemption applies to both for-profit and nonprofit entities owned solely by one or more charities or tax-exempt organizations.

However, reporting is required if the charity is not the sole owner of a business entity (for example, if the charity owns 50% while the other 50% is owned by private, non-CTA-exempt individuals or entities). In these instances, the

entity (not the charity or tax-exempt entity) will have to file a beneficial ownership report since the subsidiary is not controlled or owned entirely by CTA-exempt individuals. In this case, the entity will have to report the name of the charity or tax-exempt entity as an owner on its beneficial ownership report. Please note that the names of the individual directors/members/shareholders of the charity or tax-exempt entity need not be reported.

In summation, charities and tax-exempt entities are exempt from CTA reporting requirements. An entity not owned entirely by one or more charities and tax-exempt entities must report the charity and/or tax-exempt entity as a beneficial owner but will not report the names of individual directors/members/shareholders of the charity or tax-exempt entity.

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# The Impact of the Corporate Transparency Act on Commercial Real Estate

[Blog](#) Rocky Mountain Real Estate Law

**Otten Johnson Robinson Neff + Ragonetti PC**

**USA** | February 12 2024

The Corporate Transparency Act (“CTA”) seeks to limit the use of shell entities to hide illicit activities and to increase transparency in corporate ownership by collecting identification information of the individuals that organize and own entities. While the CTA is generally applicable to all industries, it has a disproportionate impact on the commercial real estate industry, because of the complex ownership structures that are frequently used to hold, develop, and operate real estate assets. These ownership structures often consist of numerous tiered entities, many of which will be subject to the reporting requirements of the CTA. Although the CTA will increase the administrative burden of forming new entities, there are still significant benefits to using various entity structures to own and operate real estate assets, including limiting liability and maximizing tax advantages.

## **What is required by the CTA?**

The CTA requires reporting companies to report beneficial ownership information (“BOI”) to the Financial Crimes Enforcement Network (“FinCEN”). A reporting company is an entity that is created or registered to do business in the United States by filing a document with a secretary of state or similar office. This includes corporations, limited liability companies, and limited partnerships, all of which are frequently used to hold and operate real estate assets. The CTA identifies 23 exempt entity types, however, many of these exemptions are not applicable to real estate entities, and even the exemptions that may be applicable are narrowly applied. Reporting companies are required to file reports with FinCEN that include information about the reporting company, its beneficial owners, and its company applicants.



A beneficial owner is any individual who either (1) exercises substantial control over the entity or (2) owns or controls at least 25% of the beneficial ownership interests in the entity. An individual exercises substantial control if they (i) serve as a senior officer of the reporting company (e.g., a president, chief financial officer, chief operating officer, etc.), (ii) have authority over the appointment or removal of any senior officer or a majority of the board of directors, or (iii) direct, determine, or have substantial influence over important decisions made by the reporting company. A company applicant is anyone that files, or directs or controls the filing of, the document that creates or registers the reporting company.

Entities created before January 1, 2024 have until January 1, 2025 to submit their initial report. Entities created after January 1, 2024, but before January 1, 2025 have 90 days to submit their initial report, and entities created after January 1, 2025 will have 30 days to submit their initial report. In addition to filing an initial report, reporting companies need to update reports whenever information that was initially reported to FinCEN changes. This requirement poses additional difficulties for real estate entities because changes in ownership and control of entities are common throughout the life cycle of a project.

#### **What are the next steps to comply with the CTA?**

Real estate businesses and investors should create a plan for how they will stay in compliance with the CTA. Those in control of existing entities and those that intend to form new entities should consider whether reporting is required for these entities, how they will collect and maintain the information required for initial and updated BOI reports, how they will track and report changes to ownership and control of these entities, and how to reflect these considerations in the deal making process. In many ways the process is not dissimilar to what many real estate companies must provide to lenders in connection with obtaining loans.

During the negotiation and agreement drafting process, sponsors and investors in a real estate deal should consider who will be primarily responsible for filing reports for applicable entities, how they will establish the right to collect and report BOI, how they will create an obligation for beneficial owners to supply updated information as it changes, and how they will protect confidentiality, while protecting their right to report information that is required to comply with the CTA.

Complying with the newly imposed reporting obligations should be a priority for real estate businesses and professionals because reporting companies and individuals that cause entities to fail to report the complete and accurate information called for by the CTA, may be subject to criminal and civil penalties.

# Federal District Court Declares Corporate Transparency Act (CTA) Unconstitutional

[Blog](#) Subject to Inquiry

**McGuireWoods LLP**

**USA** | March 4 2024

On March 1, 2024, the United States District Court for the Northern District of Alabama declared the Corporate Transparency Act (“CTA”) unconstitutional. Enacted as part of the Anti-Money Laundering Act of 2020, the CTA requires certain legal entities to report beneficial ownership information (“BOI”) to the U.S. Department of Treasury’s Financial Crimes Enforcement Network (“FinCEN”). The reporting provisions took effect on January 1, 2024. In *National Small Business United v. Yellen* (5:22-cv-01448-LCB), the District Court, in a memorandum opinion, rejected the Government’s position when it held that the CTA exceeds Congress’ power to regulate these business entities. The Court issued a Final Judgment on March 1<sup>st</sup> as well, permanently enjoining enforcement of the CTA against the two plaintiffs.

Pending appeal, it is not clear whether the government will continue to enforce the CTA against non-parties to the lawsuit, or what other impact this ruling will have nationally on entities subject to the CTA’s reporting requirements. McGuireWoods will be closely monitoring developments.

## Background

Plaintiffs, an Ohio non-profit corporation representing small businesses across the United States and an individual who is a member of this non-profit and a small business owner subject to the reporting provisions of the CTA, sued the Treasury Department, along with Treasury Secretary Janet Yellen and Acting Director of FinCEN Himamauli Das in their official capacities, alleging that the CTA’s mandatory disclosure requirements exceed Congress’ authority under Article I of the Constitution and violate the First, Fourth, Fifth, Ninth, and Tenth Amendments. (*Id.* at 4). The parties cross-moved for summary judgement in early 2023, and the Government simultaneously moved to dismiss the action. (*Id.*).

## The CTA is not Within Congress’ Powers to Oversee Foreign Policy

First, the Government contended that the Constitution’s Necessary and Proper Clause conferred authority to Congress to enact the CTA under its foreign affairs powers. (*Id.* at 16). The District Court rejected this contention, holding that here, Congress was bound by the Constitution’s enumerated powers limitation because incorporation and regulation of businesses are squarely creatures of state law. (*Id.* at 19).

The District Court also rejected the Government’s argument that the CTA could be justified as necessary and proper to carry out Congress’s powers to regulate foreign affairs. (*Id.* at 22). In support of its argument, the Government proffered the CTA’s congressional findings, including the finding that “malign actors seek to conceal their ownership of [corporate] entities in the United States to facilitate illicit activity, . . . harming the national security interests of

the United States and allies of the United States.” (*Id.* at 22-23, citing Pub. L. 116-283 § 6402(3)). The District Court held that these congressional findings were insufficient to conclude that the CTA is necessary and proper, simultaneously rejecting that the Necessary and Proper Clause extended to all constitutional powers. (*Id.* at 23).

### **The CTA is Not Valid Under the Commerce Clause**

Second, the Government claimed that the Commerce Clause gave Congress the power to enact the CTA, arguing that the act of corporate formation on its own is sufficient to invoke Congress’ Commerce powers. (*Id.* at 16). The Court disagreed, holding that the plain text of the CTA, which it noted made no mention of interstate commerce, does not regulate the channels and instrumentalities of commerce, let alone commercial or economic activity. (*Id.* at 27). The Court stated that Congress could have easily written the CTA to pass constitutional muster by, for example, imposing the CTA’s disclosure requirements on state entities as soon as they engaged in commerce, or from prohibiting the use of interstate commerce to launder money, finance terrorism, or evade taxes. (*Id.* at 32-33).

Observing that the CTA is “far from essential,” the District Court also held that the Commerce Clause does not extend far enough to sanction the CTA because the future activities of state entities are not sufficient to invoke Congress’s “substantial effects.” (*Id.* at 34, 43). The Court compared the CTA to FinCEN’s Customer Due Diligence rule (“CDD Rule”), which requires certain “covered financial institutions”—such as banks opening deposit accounts for customers—to “identify and verify beneficial owners of legal entity customers.” (*Id.* at 43, citing 31 C.F.R. § 1010.230(a)). According to the Court, FinCEN’s CDD Rule and the CTA provide FinCEN with nearly identical information, but the CDD Rule does so in a constitutionally acceptable way. (*Id.* at 44).[1]

### **The CTA is Not a Necessary and Proper Exercise of Congress’ Taxation Power**

Finally, the Government asserted that the CTA is a necessary and proper exercise of Congress’s authority to tax because one purpose of the BOI database created by FinCEN is to assist in efficient tax administration. (*Id.* at 16-17). The Government contends “the collection of beneficial ownership information is necessary and proper to ensure taxable income is appropriately reported,” and that Congress recognized this relationship by “draft[ing] the CTA to allow “[o]fficers and employees of the Department of the Treasury [to] obtain access to beneficial ownership information for tax administration purposes[.]”” The District Court once again rejected the Government’s argument, holding that to accept the Government’s reading of the Necessary and Proper Clause would permit passage of any law that may involve information useful to tax officials. (*Id.* at 52). In other words, the exception would quickly swallow the rule.

### **Implications**

It is not yet clear what the implications of this decision will be for entities subject to the reporting provisions under the CTA, and the District Court has not yet ruled whether there will be a nationwide injunction. McGuireWoods is monitoring the fallout from this decision and its effects on reporting companies.

McGuireWoods LLP - Jeffrey M. Hanna, Emily P. Gordy, Lauren H. Mann and Ashley E. Bouchez

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## Journal of Accountancy

# Decision holding Corporate Transparency Act unconstitutional appealed

By Martha Waggoner

23 minutes ago

The U.S. Justice Department (DOJ) appealed a federal court decision that held the Corporate Transparency Act (CTA), P.L. 116-283, which requires the reporting of beneficial ownership information (BOI) by businesses, is unconstitutional.

On Monday, the DOJ filed [its appeal](https://www.fincen.gov/sites/default/files/shared/54_Notice_of_Appeal.pdf) ([https://www.fincen.gov/sites/default/files/shared/54\\_Notice\\_of\\_Appeal.pdf](https://www.fincen.gov/sites/default/files/shared/54_Notice_of_Appeal.pdf)) of the March 1 decision by a federal district court in Alabama to grant the plaintiffs' motion for summary judgment regarding the constitutionality of the law in the case of *National Small Business United v. Yellen* (<https://law.justia.com/cases/federal/district-courts/alabama/alndce/5:2022cv01448/183445/51/>), No. 5:22-cv-1448-LCB (N.D. Ala. 3/1/24).

The holding affects only the plaintiffs, which include the 65,000 businesses that were National Small Business Administration (NSBA) members as of March 1.

Todd McCracken, the NSBA president and CEO, said the NSBA welcomes the appeal because he expects the courts to agree that the act is unconstitutional.

"If Congress does not repeal the CTA, eventually the Supreme Court will need to address this issue as well and strike down the statute for the entire United States," he said Tuesday in a statement. Under the act, which Congress passed in 2021 as an anti-money-laundering initiative, reporting companies, which are defined as corporations, limited liability companies (LLCs), and similar entities, must disclose the identity and information about beneficial owners of the entities. For new entities incorporated after Jan. 1, 2024, reporting companies must also disclose the identity of "applicants" — defined as any individual who files an application to form a corporation, LLC, or other similar entity.

Reporting companies are required to provide information about both the companies and their beneficial owners and applicants, including full legal name, address, state or tribal jurisdiction of formation, IRS taxpayer identification number, birth date, and other details. Willful violations are punishable by a fine of \$591 a day, up to \$10,000, and two years in prison with similarly serious penalties for unauthorized disclosure.

Treasury's Financial Crimes Enforcement Network (FinCEN), which administers the CTA, estimates that BOI reporting regulations apply to 32.6 million entities with 5 million to be added each year through 2034.

## **AICPA response**

In a statement after the federal court opinion, the AICPA said that small businesses should continue to file BOI reports. The statement also said that the AICPA continues to push for suspension of the BOI reporting rule.

— *To comment on this article or to suggest an idea for another article, contact Martha Waggoner at [Martha.Waggoner@aicpa-cima.com](mailto:Martha.Waggoner@aicpa-cima.com) (mailto:Martha.Waggoner@aicpa-cima.com).*

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# Comparing the Beneficial Ownership Rule and the BOI Reporting Rule

This chart compares the key requirements of the Beneficial Ownership Rule and Beneficial Ownership Information (BOI) Reporting Rule, with material differences between the analogous requirements highlighted in green and red respectively.

FAQ	BENEFICIAL OWNERSHIP RULE (2016)	BENEFICIAL OWNERSHIP INFORMATION REPORTING RULE (2022)
<p><b>Who is a beneficial owner?</b></p>	<ul style="list-style-type: none"> <li>An individual who directly or indirectly owns 25 percent or more of the equity interests of a legal entity</li> <li>A single individual with significant responsibility to control, manage, or direct a legal entity (control prong)</li> </ul> <p><i>E.g. an executive officer or senior manager, or any other individual who regularly performs similar functions</i></p>	<p><b>Any individual who directly or indirectly owns or controls 25 percent or more of the ownership interests of a reporting company</b></p> <p><b>Any individual who exercises substantial control over a reporting company</b></p> <p><b>An individual exercises substantial control over a reporting company if the individual:</b></p> <ul style="list-style-type: none"> <li>Serves as a senior officer of the reporting company;</li> <li>Has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body);</li> <li>Directs, determines, or has substantial influence over important decisions made by the reporting company</li> </ul> <p><b>A company applicant</b>, defined as:</p> <ul style="list-style-type: none"> <li>For a domestic company, the individual who files the document that creates the company</li> <li>For a foreign company, the individual who files the document first registering the company to do business in the United States</li> </ul>

FAQ	BENEFICIAL OWNERSHIP RULE (2016)	BENEFICIAL OWNERSHIP INFORMATION REPORTING RULE (2022)
<p><b>Who must report beneficial ownership information?</b></p>	<p>A <b>legal entity customer that opens a new account with a financial institution</b></p>	<p>A reporting company, defined as:</p> <ul style="list-style-type: none"> <li>• <b>Domestic corporations, LLCs or other legal entities</b> created by the filing of a document with a secretary of state or similar office</li> <li>• <b>Foreign corporations, LLCs or other legal entities registered to do business in the United States</b> by the filing of a document with a secretary of state or any similar office</li> </ul>
<p><b>Who must collect beneficial ownership information?</b></p>	<p>A <b>covered financial institution</b>, defined as:</p> <ul style="list-style-type: none"> <li>• A U.S. bank or U.S. branch of a foreign bank</li> <li>• An SEC-registered broker-dealer</li> <li>• A CFTC-registered futures commission merchant or introducing broker</li> <li>• A mutual fund</li> </ul>	<p>FinCEN</p>
<p><b>What information must be provided about a beneficial owner?</b></p>	<p><b>Name</b></p> <p><b>Date of birth</b></p> <p><b>Residential or business street address</b></p> <p><b>Identification number:</b></p> <ul style="list-style-type: none"> <li>• For a U.S. person, a <b>taxpayer identification number (TIN)</b></li> <li>• For a non-U.S. person, one or more of the following: A <b>TIN</b>; passport number and country of issuance; <b>alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard</b></li> </ul> <p><b>Documentary or non-documentary verification of the information above</b></p>	<p><b>Full legal name</b></p> <p><b>Date of birth</b></p> <p><b>Complete current address:</b></p> <ul style="list-style-type: none"> <li>• For a <b>company applicant who forms or registers an entity in the course of its business, the street address of such business</b></li> <li>• In any other case, residential street address</li> </ul> <p><b>Unique identifying number and issuing jurisdiction from one of the following documents:</b></p> <ul style="list-style-type: none"> <li>• A non-expired U.S. passport</li> <li>• A non-expired identification document issued to the individual by a State, local government, or Indian tribe for the purpose of identifying the individual;</li> <li>• A non-expired driver's license issued to the individual by a State; or</li> <li>• A non-expired passport issued by a foreign government, if the individual does not possess any of the documents described above; and</li> </ul> <p><b>An image of the document from which the unique identifying number was obtained</b></p>

FAQ	BENEFICIAL OWNERSHIP RULE (2016)	BENEFICIAL OWNERSHIP INFORMATION REPORTING RULE (2022)
<p><b>Who is fully-exempt from reporting beneficial ownership information?</b></p>	<ul style="list-style-type: none"> <li>• A financial institution regulated by a federal functional regulator or a bank regulated by a U.S state bank regulator</li> <li>• A bank holding company or savings and loan holding company</li> <li>• A federal, state or other local governmental department, agency or other authority</li> <li>• An SEC-registered or reporting company, investment company, investment adviser, exchange or clearing agency or other entity</li> <li>• An NYSE or a NASDAQ-listed company, other than a bank <ul style="list-style-type: none"> <li>– A subsidiary that is at least 51% owned by such listed company, other than a bank, but a nonbank financial institution is exempt only to the extent of its domestic operations</li> </ul> </li> <li>• A CFTC-registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant</li> <li>• A PCAOB-registered public accounting firm</li> <li>• A pooled investment vehicle operated or advised by an exempt financial institution</li> <li>• An insurance company regulated by a state</li> <li>• An FSOC-designated financial market utility</li> <li>• A foreign financial institution established in a jurisdiction where the regulator of such institution maintains beneficial ownership information regarding such institution</li> <li>• A non-U.S. governmental department, agency or political subdivision that engages only in governmental rather than commercial activities</li> </ul>	<ul style="list-style-type: none"> <li>• A national bank, state bank or trust company, and any federal branch and insured branch</li> <li>• A federal or state credit union</li> <li>• A bank holding company or savings and loan holding company</li> <li>• A federal, state or other local governmental department, agency or other authority</li> <li>• An SEC-registered or reporting company, broker/dealer, exchange or clearing agency, investment company, investment adviser or other entity</li> <li>• A futures commission merchant, introducing broker, swap dealer, major swap participant, commodity pool operator, or commodity trading advisor or other entity registered with the CFTC</li> <li>• A PCAOB-registered public accounting firm</li> <li>• A pooled investment vehicle operated or advised by an exempt bank, credit union, broker/dealer, investment company/adviser or venture capital fund adviser</li> <li>• An insurance company regulated by a state</li> <li>• An insurance producer regulated by a state and that operates a physical office within the United States</li> <li>• An FSOC-designated financial market utility</li> <li>• A FinCEN-registered money services business (MSB)</li> <li>• A venture-capital fund that makes the requisite SEC filings</li> <li>• A regulated public utility that provides telecommunications services, electrical power, natural gas, or water and sewer services within the United States</li> </ul>



FAQ	BENEFICIAL OWNERSHIP RULE (2016)	BENEFICIAL OWNERSHIP INFORMATION REPORTING RULE (2022)
	<ul style="list-style-type: none"> <li>Any legal entity only to the extent that it opens a private banking account subject to a due diligence program under the BSA regulations</li> </ul>	<ul style="list-style-type: none"> <li>A <b>tax-exempt entity</b> under 501(c), 527(e)(1) or 4947(a) of the Internal Revenue Code</li> <li>A <b>U.S.-owned and domiciled entity that operates exclusively to provide financial assistance to, or hold governance rights over, a tax-exempt entity</b> and derives a majority of its funding or revenue from U.S. citizens or permanent residents</li> <li>An <b>entity that:</b> <ul style="list-style-type: none"> <li>Employs more than 20 full-time employees in the United States;</li> <li>Has an operating presence at a physical location in the United States; and</li> <li>Filed a federal tax return for the previous year demonstrating more than \$5,000,000 in gross receipts or sales</li> </ul> <p>For an entity that is part of an affiliated group of corporations that filed a consolidated return, the applicable amount is the amount reported on the consolidated return</p> </li> <li>An <b>entity controlled or wholly owned</b> by one or more entities that is a securities reporting issuer, government authority, bank, credit union, depository institution holding company, broker/dealer, securities exchange or clearing agency, other Exchange Act registered entity, investment company/adviser, venture capital fund adviser, insurance company, state-licensed insurance producer, Commodity Exchange Act-registered entity, accounting firm, public utility, financial market utility tax-exempt entity or large operating company listed above</li> <li>An <b>entity formed before January 1, 2020</b>, that: <ul style="list-style-type: none"> <li>Is not engaged in active business</li> <li>Is not partially or wholly owned by a foreign person, whether directly or indirectly</li> <li>Has not experienced any change in ownership in the preceding twelve-month period</li> <li>Has not sent or received funds greater than \$1,000, either directly or through any financial account in which the entity or any affiliate of the entity had an interest, in the preceding twelve months</li> </ul> </li> </ul>

FAQ	BENEFICIAL OWNERSHIP RULE (2016)	BENEFICIAL OWNERSHIP INFORMATION REPORTING RULE (2022)
<p><b>Who is partially exempt from reporting beneficial ownership information?</b></p>	<p>The following legal entity customers are subject only to the control prong:</p> <ul style="list-style-type: none"> <li>• A pooled investment vehicle that is operated or advised by a financial institution not fully-exempt from reporting beneficial ownership information</li> <li>• Any legal entity that is established as a nonprofit corporation or similar entity and has filed its organizational documents with the appropriate State authority as necessary</li> </ul>	<ul style="list-style-type: none"> <li>• If one or more exempt entities has a direct or indirect ownership interest in a reporting company and an individual is a beneficial owner of the reporting company exclusively by virtue of the individual's ownership interest in such exempt entities, the beneficial ownership report may include the names of the exempt entities in lieu of the beneficial owner's information</li> <li>• A <b>minor child</b>, provided the reporting company reports the required information of a <b>parent or legal guardian</b> of the minor child</li> <li>• A <b>foreign</b> pooled investment vehicle operated or advised by an exempt bank, credit union, broker/dealer, investment company/adviser or venture capital fund adviser must report information with respect to the <b>individual who has the greatest authority over the strategic management of the entity</b></li> <li>• A company formed before January 1, 2024, is not required to report information with respect to any company applicant</li> </ul>
<p><b>Who is partially-exempt from collecting beneficial ownership information?</b></p>	<p>A covered financial institution is exempt from collecting beneficial ownership information to the extent that it opens an account for a legal entity customer that is:</p> <ul style="list-style-type: none"> <li>• At the point-of-sale to provide credit products, solely for the purchase of retail goods and/or services at these retailers, up to a limit of \$50,000;</li> <li>• To finance the purchase of postage and for which payments are remitted directly by the financial institution to the provider of the postage products;</li> <li>• To finance insurance premiums and for which payments are remitted directly by the financial institution to the insurance provider or broker;</li> <li>• To finance the purchase or leasing of equipment and for which payments are remitted directly by the financial institution to the vendor or lessor of this equipment</li> </ul>	<p>N/A</p>

FAQ	BENEFICIAL OWNERSHIP RULE (2016)	BENEFICIAL OWNERSHIP INFORMATION REPORTING RULE (2022)
<p><b>When must beneficial ownership information be reported / collected?</b></p>	<p>At the time a legal entity customer opens a new account with a covered financial institution</p>	<ul style="list-style-type: none"> <li>• For domestic companies formed from January 1, 2024 to December 31, 2024, within 90 days of notice of creation</li> <li>• For foreign companies becoming a foreign reporting company from January 1, 2024 to December 31, 2024, within 90 days of notice of registration</li> <li>• For domestic companies or foreign reporting companies formed or registered before January 1, 2024, by January 1, 2025.</li> <li>• For domestic companies formed on or after January 1, 2025, within 30 days of notice of creation</li> <li>• For foreign companies becoming a foreign reporting company on or after January 1, 2025, within 30 days of notice of registration</li> </ul>
<p><b>When must beneficial ownership information be updated?</b></p>	<p>On a risk basis, when in the course of normal monitoring, a financial institution becomes aware of information about a customer or an account, including a possible change of beneficial ownership information, relevant to assessing or reassessing the customer's overall risk profile</p>	<p>Within 30 days after the date on which a change in beneficial ownership information occurs, by filing an updated report</p> <p>If any beneficial ownership information report was inaccurate when filed and remains inaccurate, within 30 calendar days after the date on which the reporting company becomes aware or has reason to know of the inaccuracy, by filing a corrected report</p>
<p><b>Where must beneficial ownership information be reported</b></p>	<p>To a covered financial institution, upon the opening of a new account</p>	<p>FinCEN online filing system</p>
<p><b>Who can update beneficial ownership information?</b></p>	<p>Not specified – however, for enforceability reasons certification of beneficial owners should be provided by a person authorized to act on behalf of the reporting company</p>	<p>Not specified – however, for enforceability reasons a beneficial ownership information report should be provided by a person authorized to act on behalf of the reporting company</p>



Financial Crimes Enforcement Network  
U.S. Department of the Treasury  
Washington, D.C. 20220



# Beneficial Ownership Information Reporting Frequently Asked Questions

These Frequently Asked Questions are explanatory only and do not supplement or modify any obligations imposed by statute or regulation. Please refer to the Beneficial Ownership Information Reporting Rule, available at [www.fincen.gov/boi](http://www.fincen.gov/boi), for details on specific provisions. FinCEN expects to publish further guidance in the future. Questions on any of this content can be directed to <https://www.fincen.gov/contact>.

## **A. General Questions**

### **A.1. What is beneficial ownership information?**

Beneficial ownership information refers to identifying information about the individuals who directly or indirectly own or control a company.

[Issued March 24, 2023]

### **A.2. Why do companies have to report beneficial ownership information to the U.S. Department of the Treasury?**

In 2021, Congress passed the Corporate Transparency Act on a bipartisan basis. This law creates a new beneficial ownership information reporting requirement as part of the U.S. government's efforts to make it harder for bad actors to hide or benefit from their ill-gotten gains through shell companies or other opaque ownership structures.

[Issued September 18, 2023]

### **A.3. Under the Corporate Transparency Act, who can access beneficial ownership information?**

FinCEN will permit Federal, State, local, and Tribal officials, as well as certain foreign officials who submit a request through a U.S. Federal government agency, to obtain beneficial ownership information for authorized activities related to national security, intelligence, and law enforcement. Financial institutions will have access to beneficial ownership information in certain circumstances, with the consent of the reporting company. Those financial institutions' regulators will also have access to beneficial ownership information when they supervise the financial institutions.

FinCEN published the rule that will govern access to and protection of beneficial ownership information on December 22, 2023. Beneficial ownership information reported to FinCEN will be stored in a secure, non-public database using rigorous information security methods and controls typically used in the Federal government to protect non-classified yet sensitive information systems at the highest security level. FinCEN will work closely with those authorized to access beneficial ownership information to ensure that they understand their roles and responsibilities in using



# Key highlights of FinCEN's final rule on access to Beneficial Ownership Information

**Eversheds Sutherland (US) LLP**

**USA** | January 3 2024

## **Key highlights of FinCEN's final rule on access to Beneficial Ownership Information**

The Financial Crimes Enforcement Network (FinCEN) issued the Beneficial Ownership Information Access and Safeguards Rule<sup>1</sup> (Access Rule) establishing the framework for access to and protection of beneficial ownership information (BOI). The Access Rule is the second of three rulemakings required to implement the Corporate Transparency Act (CTA), which was enacted to “strengthen the integrity of the US financial system”<sup>2</sup> and reduce abuse of the US financial system for money laundering and other illicit financial activity.<sup>3</sup> The Access Rule largely adopted FinCEN's Notice of Proposed Rulemaking issued on December 16, 2022<sup>4</sup> (NPRM), with slight modifications responsive to the comments received. The Access Rule takes effect on February 20, 2024.

BOI reported to FinCEN will be housed in a national database that FinCEN launched January 1, 2024 (BO IT System). The CTA authorizes FinCEN to disclose BOI to five categories of recipients: (1) financial institutions; (2) regulatory agencies; (3) domestic recipients; (4) foreign requesters; and (5) the US Department of Treasury. Authorized recipients of BOI must use the information for the “particular purpose or activity for which such information was disclosed.”<sup>5</sup> FinCEN can authorize the re-disclosure of BOI via written consent, or through applicable protocols or guidance, that FinCEN may issue.<sup>6</sup> The Access Rule also provides specific steps to request BOI and confidentiality and security requirements based on the category of authorized recipient. As further explained below, financial institutions should begin preparing to comply with the requesting process and mandatory security and confidentiality protocols prescribed by the Access Rule.

### **1. Financial Institutions**

Authorized Purpose: Financial institutions can request BOI to facilitate their compliance with customer due diligence requirements under applicable law. Financial institutions' requests for BOI should directly relate to its “compliance with a legal obligation . . . designed to counter money laundering or the financing of terrorism, or to safeguard the national security of the United States.”<sup>7</sup> While the Access Rule is broadly drafted to permit “financial institutions” to access BOI from the BO IT System, “FinCEN, in the exercise of its discretion, intends to permit only financial institutions with obligations under the 2016 CDD Rule to have access to the BO IT System.”<sup>8</sup>

How to Request: A financial institution needs the reporting company's consent to request its BOI. This consent must be documented (but it does not have to be in writing) and maintained for five years after the financial institution last relied upon the consent in connection with the request for BOI.<sup>9</sup> Additionally, the financial institution must make a written certification that it: (1) is requesting the information to facilitate its compliance with customer due diligence requirements under applicable law, (2) obtained the reporting company's consent, and (3) fulfilled the other security and confidentiality requirements.

Financial institutions are authorized to re-disclose BOI information received from FinCEN under the following circumstances:

- Any director, officer, employee, contractor, or agent of a financial institution who received BOI from FinCEN may re-disclose the information to another director, officer, employee, contractor, or agent of the same financial institution for the particular purpose or activity for which the BOI was requested.
- Financial institutions can re-disclose BOI to regulators that meet certain requirements set forth in the Access Rule.<sup>10</sup>

*Security and Confidentiality Requirements:* Financial institutions must develop and implement administrative, technical, and physical safeguards reasonably designed to protect BOI as a precondition for receiving BOI. Financial institutions must implement security and information handling procedures that satisfy the requirements of section 501 of the Gramm-Leach-Bliley Act and its implementing regulations.<sup>11</sup> In addition, financial institutions will need to notify FinCEN within three business days if it receives a foreign government subpoena or legal demand that would require disclosure of the received BOI. They also will need to ensure that the BOI is not available to persons physically located in, and is not stored in, certain jurisdictions, such as the People's Republic of China, the Russian Federation, and countries deemed to be a state sponsor of terrorism or subject to comprehensive financial or economic sanctions.

## 2. Regulatory Agencies

*Authorized Purpose:* Federal functional regulators and other appropriate regulatory agencies acting in a supervisory capacity assessing financial institutions for compliance with customer due diligence requirements can access BOI previously made available to the financial institutions that they supervise.<sup>12</sup> Additionally, the rule allows regulatory agencies to use BOI to conduct “the assessment, supervision, or authorized investigation” in connection with a financial institution’s use of BOI obtained from FinCEN to comply with legal requirements to counter money laundering or the financing of terrorism, or to safeguard the national security of the United States.<sup>13</sup> *How to Request:* For a regulatory agency to request BOI, the regulatory agency must certify that it (1) is acting in its supervisory capacity, (2) will use BOI solely for that purpose, (3) and has entered into an agreement with FinCEN to properly safeguard BOI received. Regulatory agencies will be able to retrieve any BOI that the financial institutions they supervise received from FinCEN during a particular period, but will not be able to broadly search the BO IT System.<sup>14</sup> The Access Rule also includes a provision that would permit FinCEN to disclose BOI to any “other appropriate regulatory agency that assessed, supervised, enforced, or otherwise determined the compliance of such financial institution with customer due diligence requirements under applicable law.” FinCEN noted that state bank supervisors, as defined in the AML Act, state credit union regulators and other state supervisory authorities that meet the criteria set forth in the Access Rule may have access to the BO IT System. However, although SROs are not a part of this category the Access Rule allows qualifying SROs to receive BOI disclosed to them from a financial institution or Federal functional regulator.<sup>15</sup> *Security and Confidentiality Requirements:* Any access to and use of BOI obtained from the BO IT System must comply with the requirements of the CTA and the Access Rule.

## 3. Domestic Recipients

*Authorized Purpose:* Federal agencies engaged in “national security,” “intelligence,” or “law enforcement activity” can request BOI if the requested BOI is limited in scope and for use in furtherance of such activity.<sup>16</sup> State, local and Tribal law enforcement agencies (Local Enforcement Agencies) also can request BOI if “a court of competent jurisdiction” has authorized the law enforcement agency to seek the information in a criminal or civil

investigation.<sup>17</sup> Local Enforcement Agencies can obtain court authorization from a variety of court officers (including a judge, clerk of the court, or magistrate), but “being an attorney, by itself, is not sufficient to... grant the required court authorization under the CTA.”<sup>18</sup> How to Request: A federal agency must certify that (1) it is engaged in a national security, intelligence, or law enforcement activity, and (2) that BOI requested is for use in such activity, along with the specific reasons why BOI is relevant to the activity. Local Enforcement Agencies must (1) certify that they have received authorization to seek BOI from a court of competent jurisdiction and that requested BOI is relevant to a civil or criminal investigation, and (2) provide a description of the information the court has authorized the agency to seek. Federal, state, local, or Tribal agencies are permitted to re-disclose BOI for making a referral to another state, local, or Tribal agency for possible prosecution. FinCEN declined to include a “joint investigation” provision in the Access Rule and indicated that it would issue guidance to address this scenario. Security and Confidentiality Requirements: To be eligible to receive BOI from FinCEN, a domestic requesting agency must establish standards and procedures to protect the security and confidentiality of BOI, restrict access to BOI, and provide reports and certifications throughout the year to FinCEN.

#### 4. Foreign Requesters

Authorized Purpose: Foreign law enforcement agencies, judges, prosecutors, central authorities, and competent authorities (Foreign Requesters) can request BOI for assistance in a law enforcement investigation or prosecution, or for a national security or intelligence activity, authorized under the laws of the foreign country.<sup>19</sup> How to Request: Foreign Requesters must (1) make their request through a Federal agency, (2) tailor their request to be for assistance in a law enforcement investigation or prosecution, or for a national security or intelligence activity, authorized under the laws of the foreign country, and (3) make their request pursuant to an international treaty, agreement, or convention, or, when no agreement is available, be an official request by a law enforcement, judicial, or prosecutorial authority of a trusted foreign country.<sup>20</sup> Security and Confidentiality Requirements: Foreign Requesters who request BOI when a treaty, agreement, or convention applies must handle, disclose, and use BOI consistent with the requirements of the applicable international treaty, agreement, or convention under which it was requested. Foreign Requesters who make a BOI request when no treaty, agreement, or convention applies must (1) have security standards and procedures, (2) maintain a secure storage system that complies with the security standards that the foreign requester applies to the most sensitive unclassified information it handles, (3) minimize the amount of information requested, and (4) restrict personnel access to BOI to persons who have undergone training on the appropriate handling and safeguarding.<sup>21</sup>

#### 5. US Department of the Treasury

Officers or employees of the US Department of the Treasury can access BOI when “official duties require such inspection or disclosure, subject to internal procedures and safeguards.” The access also extends to officers or employees of the Department of the Treasury for tax administration.

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FinCEN has yet to propose the third rule revising the 2016 CDD Rule to be consistent with the CTA’s requirements. In the meantime, financial institutions with customer due diligence obligations can use the information in the Access Rule to begin implementing the procedures and controls that will be required to access BOI. These financial institutions should ensure that their systems and procedures fully comply with section 501 of the Gramm-Leach-Bliley Act, and implement procedures and controls for obtaining and maintaining record of customers’ consent, promptly notifying FinCEN about foreign government subpoenas or legal demands that require disclosure of BOI,

and limiting BOI access to certain jurisdictions. In addition, financial institutions may want to consider updating their policies, procedures, and trainings regarding the handling of customers' nonpublic personal information to account for these changes, and creating a plan to audit whether BOI received from FinCEN has been accessed and used appropriately.

**Eversheds Sutherland (US) LLP** - Craig T. Alcorn, Xenia J. Garofalo and Andrea L. Gordon

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# Community Reinvestment Act Final Rule

Fredrikson & Byron PA



USA | March 1 2024

The Community Reinvestment Act final rule is almost 1,500 pages and undoubtedly challenging to digest. As of the drafting of this article, the final rule has not been published in the Federal Register, and this article is based on the version published on the federal banking agencies' websites on October 24, 2023. Because there are more topics than can be covered in a short summary, this article will discuss only the:

1. effective and applicability dates;
2. size or other coverage definitions;
3. basics of the tailored evaluation framework structure; and
4. basics of the new Retail Lending Test (RL Test), which could apply to small, intermediate, or large banks.

## Effective Versus Applicability Dates

The provisions of the final rule are *effective* on April 1, 2024. However, most of the provisions are not *applicable* (read: enforceable) until January 1, 2026, and reporting requirements related to data on operations subsidiaries, affiliates, community development (CD) loans and investments, and assessment area (AA) data are not applicable until January 1, 2027. The reporting date is April 1 for subsequent years.

## Small, Large, or Something Else?

The final rule, like the existing rule, does not apply equally to all banks. The final rule revised the thresholds for small, intermediate, and large banks, each of which is subject to different requirements under the final rule related to certain data collection and reporting and maintenance obligations, as well as different performance evaluation elements:

1. A small bank will be a bank that has less than \$600 million in assets in each of the prior two calendar years;
2. An intermediate bank will be a bank that had \$600 million or more in assets in each of the prior two calendar years, but less than \$2 billion in assets in at least one of the prior two calendar years; and
3. A large bank will be a bank that has at least \$2 billion in assets in each of the prior two calendar years.

“Something else” is any financial institution that either (1) is not a small, intermediate, or large bank, or (2) *is* a small, intermediate, or large bank but is subject to additional requirements or opts to use something other than the standard tests applicable to it. This article cannot cover all the variations in detail. Institutions in the three “something else” groups below should review the final rule carefully for either special provisions or additional requirements that may apply to them.

**The first group** includes limited purpose banks and those examined under a strategic plan. Any bank currently designated as a limited purpose or wholesale bank will continue to be considered a “limited purpose bank” under the new rule unless it (1) applies to revoke the designation or (2) is otherwise notified by its regulatory agency. Certain other banks could apply for such designation.

A bank may still apply to be examined under a strategic plan; however, the changes in the final rule likely will make it harder for a bank to demonstrate the need for a strategic plan evaluation. Banks currently operating under or considering a strategic plan should review the procedural and substantive changes to confirm their eligibility and determine the best option.

**The second group** is a special group of large banks. The agencies created two subsets of large banks which have more or different requirements under the final rule. In general, the subsets are large banks that had assets of more than \$10 billion or large banks with \$10 billion or less that do not have any branches. Examples of the additional requirements include, but are not limited to:

1. special deposit reporting;
2. providing information related to the digital and other delivery systems of the bank; and
3. additional data and reporting requirements necessary to evaluate the subsets of large banks slightly differently than the other large banks.

**The third group** is small, intermediate, or large banks that opt into some new requirements that may not otherwise apply to them. For example, a small bank can opt to be evaluated under the new RL Test, and an intermediate or small bank can opt to be evaluated outside its retail lending area for its major product lines, even if it originated 50% or less of its closed-end home mortgages, small business loans, small farm loans, and automobile loans (if applicable) in its facility-based AA(s).

### **They Want to Look at What?**

Under the final rule, how an institution is evaluated depends mostly on its size. Large banks will be subject to an RL Test, a Retail Services and Products Test (RSP Test), a CD Financing (CDF) Test (which combines CD loans and CD investments), and a CD Services (CDS) Test, with different weighting assigned to each test (CDF and RL will each be 40% and RSP and CDS each 10%). In order to earn an overall rating of Satisfactory or Outstanding in any state, multistate MSA, or for the institution as a whole, large banks with ten or more facility-based or retail lending-based AAs must receive at least a “Low Satisfactory” rating in 60% or more of its total facility-based and retail lending-based AAs in such state, multistate MSA, or for the overall institution.

An intermediate bank will be evaluated under the RL Test and either the existing CD Test or, if they opt in, the new CDF Test. The RL Test will be weighted 50%, and the other test will be weighted 50%. A small bank will be evaluated under the “Lending Test” in the existing CRA regulations or, if they opt in, the RL Test. Either test will be weighted 100%. Limited purpose banks will be evaluated under the CDF Test, and those with a strategic plan will be evaluated under their approved strategic plan. There are many other options and choices depending on bank size and applicable tests, but the above are the main choices for banks related to evaluation.

### **Retail Lending Test**

The new RL Test applies to large, intermediate, and, if they opt in, small banks (as each is defined under the new rule). As revised, the RL Test includes three different analyses: (i) a Retail Lending Volume Screen (RLVS), (ii) a determination of the Major Product Lines, and (iii) an evaluation of the distribution of its major product lines in each

## RL Test Area.

The RLVS is applied to the bank's facility-based AAs. The evaluation includes home mortgage, multifamily loans, small business loans, and small farm loans. It will also include automobile loans if they are more than 50% of the total retail lending in each of the two years before the first year of the evaluation period or if the bank elects to have automobile loans evaluated. Home mortgage includes closed-end and open-end mortgage loans as defined in the rule. The evaluation sums the total dollar volume of this lending over the evaluation period and then divides it by a summed annual dollar amount of deposits for the AA (the source of the deposit data differs based on size of the bank). This is then compared to a market volume metric to determine whether it exceeds 30% of the market volume metric for the AA. If it does, it passes the screen. If it does not, then other factors are evaluated.

The Major Product Lines analysis determines which product lines will be evaluated to determine the number of loans to low- or moderate-income (LMI) borrowers, in LMI census tracts, or to small businesses or small farms.

**Facility-based AA or outside retail lending areas:** Closed-end home mortgage loans (*note this does not include open-end mortgage loans*), small business loans, small farm loans, and, if applicable, automobile loans constitute a "major" product line if the loans for each product equal 15% or more of the bank's lending across all product lines in the area. The 15% considers loan count and loan volume and then averages the two. If a bank has no major products in a particular facility-based AA, the volume screen alone is used to determine the bank's performance in that AA.

**Retail lending AAs:** A product is "major" if it was sufficient to warrant the AAs creation (e.g., 150 or more closed-end mortgage loans or 400 or more small business loans in two consecutive years). (*Note that small farm lending, automobile lending, and other products are not major products for retail lending AAs.*)

Distribution analysis is then performed on the bank's major product lines in each AA for which there was a major product. The distribution analyses include LMI borrowers, loans to businesses with "low" (\$250,000 or less) or "moderate" (greater than \$250,000 but no more than \$1 million) gross annual revenues, and loans in LMI census tracts (collectively, LMI Loans). Each of these is evaluated separately for each major product in each AA. The analyses evaluate loan counts (*not dollar amounts*) of the bank's LMI Loans.

The results are then compared against a market benchmark and a community benchmark, providing agencies with a view of how the bank compares to its peers, as well as how well it helps the community (regardless of peers' performance). The final rule establishes specific ranges for each of the potential performance ratings for each benchmark and requires the agency to multiply each of the benchmarks by specified multipliers to determine the performance ratings. The agency must use the lesser of the two benchmark multiplier results in the comparison for each facility-based AA.

Each product rated within each AA will receive a score for each part of the distribution analysis. The examiners then calculate a weighted average, based on demographics, to weight each score and calculate a final weighted score by product line for each AA. Those are further used to determine weighted scores by state, MSA, and for an overall rating.

Did you get all that? I warned you it was complicated. As indicated at the start, the final rule is long and complex. Banks should perform a careful review to establish precisely how the new rule will impact CRA planning and examinations going forward.

*Home // Resources // Bankers // Community Reinvestment Act*

## Banker Resource Center

# Community Reinvestment Act (CRA)

Last Updated: January 29, 2024

### Final Rule on Community Reinvestment Act

#### Summary

On October 24, 2023, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency issued a final rule to strengthen and modernize regulations implementing the Community Reinvestment Act (CRA) to better achieve the purposes of the law. The CRA is a landmark law enacted in 1977 to address systemic inequities in access to credit. The CRA encourages federally insured banks to help meet the credit needs of the communities in which they do business, especially low- and moderate-income (LMI) communities, consistent with safe and sound operations.

#### Objectives of Final Rule

Building on feedback from stakeholders and research, the final rule updates the CRA regulations to achieve the following eight key objectives:

- Strengthen the achievement of the core purpose of the statute.

## CRA Final Rule Overview



- Adapt to changes in the banking industry, including the expanded role of mobile and online banking.
- Provide greater clarity and consistency in the application of the regulations.
- Tailor performance standards to account for differences in bank size, business models, and local conditions.
- Tailor data collection and reporting requirements and use existing data whenever possible.

- Promote transparency and public engagement.
- Confirm that CRA and fair lending responsibilities are mutually reinforcing.
- Promote a consistent regulatory approach that applies to banks regulated by all three agencies.

## Final Rule on Community Reinvestment Act Regulations

### Community Reinvestment Act and Public Comments

Find and submit a comment on upcoming CRA examination and/or a pending bank application.

MAKE A COMMENT

Applications Subject to CRA and Regional Office Contact Information

CRA Information from Other Federal Agencies

CRA Examination Schedule and Ratings

Community Reinvestment Act (CRA) Guidance & Policy

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## Fact Sheets

# Interagency Overview of the Community Reinvestment Act Final Rule

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Last Updated: October 24, 2023

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### Background

On October 24, 2023, the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation issued a final rule to strengthen and modernize regulations implementing the Community Reinvestment Act (CRA) to better achieve the purposes of the law. The CRA is a landmark law enacted in 1977 to address systemic inequities in access to credit. The CRA encourages federally insured banks to help meet the credit needs of the communities in which they do business, especially low- and moderate-income (LMI) communities, consistent with safe and sound operations.

The final rule and other supporting materials (including a press release and fact sheet) can be found on each agency's respective website.

### Objectives and Key Elements of Final Rule

The agencies recognize that the CRA regulations must evolve to address the significant changes in the banking industry that have taken place since the last comprehensive interagency update in 1995.

Building on feedback from stakeholders and research, the final rule updates the CRA regulations to achieve the following eight key objectives:

### **1. Strengthen the achievement of the core purpose of the statute.**

The rule seeks to ensure that the CRA continues to be a strong and effective tool to address inequities in access to credit. To achieve this objective, the rule

- evaluates bank engagement with LMI individuals and communities, small businesses, and small farms, including conducting separate assessments of large bank activities using four tests: (1) retail lending, (2) retail services and products, (3) community development (CD) financing, and (4) CD services
- enhances financial inclusion by supporting Minority Depository Institutions and Community Development Financial Institutions, Native Land Areas, persistent poverty areas, and other high-need areas
- emphasizes smaller loans and investments that can have high impact and be more responsive to the needs of LMI communities

### **2. Adapt to changes in the banking industry, including the expanded role of mobile and online banking.**

The rule recognizes the significant changes in bank business models and how banking services are delivered, including through the use of internet and mobile banking and hybrid models that combine physical footprints with online lending. To achieve this objective, the rule

- maintains a focus on evaluating bank performance in areas where banks have deposit-taking facilities while also evaluating retail lending activities occurring in “Retail Lending Assessment Areas” outside of these areas. The new rule also provides consideration for banks’ community development activities nationwide

### **3. Provide greater clarity and consistency in the application of the regulations.**

The rule addresses feedback on the need for more clarity and consistency in the application of the CRA regulations. To achieve this objective, the rule

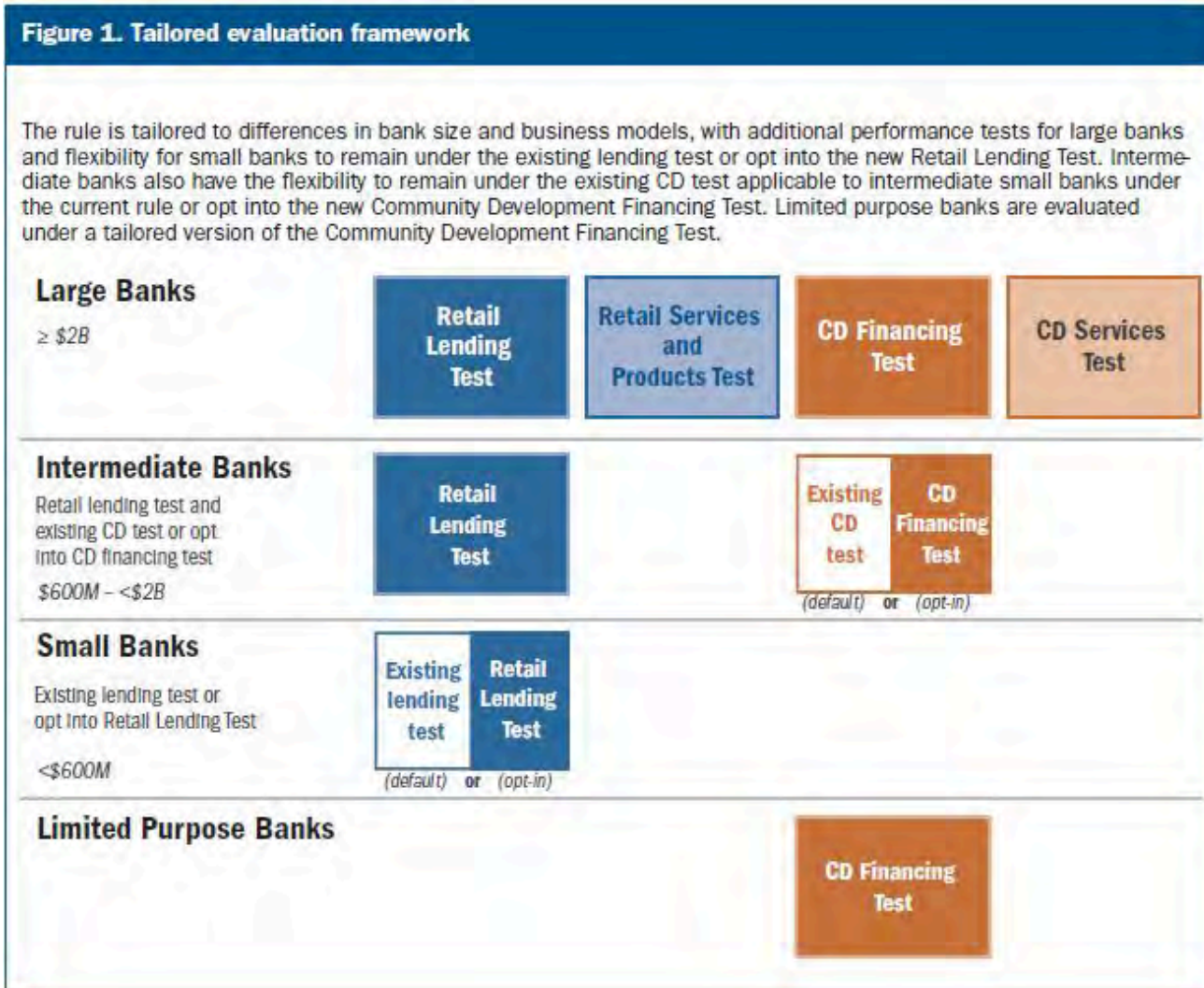


- adopts new metrics and benchmarks used by the agencies to assess retail lending performance that translate into performance conclusions
- encourages CD activities that are responsive to the needs of LMI individuals and communities, small businesses, and small farms by clarifying what activities will receive CRA credit (such as affordable housing), providing for a public list and approval process to confirm an activity's eligibility, and evaluating CD activities in light of their impact

#### 4. Tailor performance standards to account for differences in bank size, business models, and local conditions.

The rule recognizes differences in bank size and business models. To achieve this objective, the rule

- updates asset size thresholds for small, intermediate, and large banks to account for changes in the banking industry: (1) small banks: <\$600M (from <\$376M); (2) intermediate banks: \$600M–<\$2B (from \$376M–\$1.503B); and (3) large banks: ≥\$2B (from ≥\$1.503B), adjusted annually for inflation
- utilizes community and market benchmarks that reflect differences in local conditions
- continues to provide a tailored performance evaluation framework with different performance tests based on bank size and business model (see [figure 1](#)). For example, small banks will continue to be evaluated under the existing framework with the option to be evaluated under the new framework.



5. Tailor data collection and reporting requirements and use existing data whenever possible.

The rule seeks to strike an appropriate balance between minimizing unnecessary burden on community banks and providing greater clarity and consistency in how large banks are assessed by establishing the use of standardized metrics for certain banks and tailoring the associated data collection, maintenance, and reporting requirements. To achieve this objective, the rule

- exempts small and intermediate banks from new data collection requirements that apply to banks with assets of at least \$2 billion
- limits certain data collection and reporting requirements to large banks with assets greater than \$10 billion

## 6. Promote transparency and public engagement.

The rule recognizes that transparency and public engagement are fundamental aspects of the CRA evaluation process. To achieve this objective, the rule

- provides greater transparency for existing data available under the Home Mortgage Disclosure Act (HMDA)—related to the race, ethnicity, and income of bank borrowers and applicants—for large banks, by assessment area. Data will be provided on agency websites for disclosure purposes only
- codifies the practice of forwarding to the bank all public comments received by the agencies regarding a bank's CRA performance
- encourages the public to submit comments on community needs and opportunities
- provides in supplementary information that the agencies will develop data tools that use reported loan data to calculate metrics and benchmarks in different geographic areas in recent years, allowing banks and the public to have additional insight into the performance standards

## 7. Confirm that CRA and fair lending responsibilities are mutually reinforcing.

The rule affirms that, in meeting the credit needs of their entire communities, banks must do so in a fair and equitable manner. The rule

- continues to prohibit banks from delineating facility-based assessment areas that reflect illegal discrimination or arbitrarily exclude LMI census tracts
- retains and clarifies the provision that CRA ratings can be downgraded as a result of discriminatory and other illegal credit practices

## 8. Promote a consistent regulatory approach that applies to banks regulated by all three agencies.

The rule recognizes the importance of consistency across the three agencies. The rule

- provides a unified approach from the three banking agencies that is responsive to feedback from stakeholders on the need for consistent regulations

The agencies will continue their interagency work to ensure consistent implementation of a final rule through examiner and industry training, interagency examination procedures, and joint publication of an illustrative list of eligible CD activities.

## Key Changes in Final Rule

Based on an analysis of comment letters and further agency review, the final rule includes the following key changes from the proposed rule

### 1. Reduces complexity and data requirements while providing a consistent and comprehensive approach to evaluating banks under the Retail Lending Test.

- reduces the number of major product lines potentially evaluated under the new Retail Lending Test from six to three: (1) closed-end home mortgage loans; (2) small business loans; and (3) small farm loans
- limits the evaluation of automobile lending to banks subject to the Retail Lending Test that
  - are majority automobile lenders (i.e., banks for which more than 50 percent of their lending comprises automobile loan purchases or originations, out of total automobile, home mortgage, multifamily, small business, and small farm lending); or
  - opt to have their automobile lending evaluated

### 2. Adjusts retail lending performance ranges while maintaining high standards; also increases weighting of CD financing activities

- adjusts standards to make “Low Satisfactory”, “High Satisfactory”, and “Outstanding” conclusions under the Retail Lending Test more achievable while still maintaining appropriate and locally calibrated standards
- for large banks, gives equal weight to retail activities and CD activities (compared to a proposed 60 percent retail/40 percent CD split). The equal weight was broadly supported by stakeholders to encourage banks to focus on CD activities in addition to retail activities by providing additional emphasis in the banks' ratings

### **3. Retains evaluation of banks with significant retail lending outside of branches while increasing tailoring of the retail lending assessment area approach.**

- tailors requirements for delineating retail lending assessment areas (RLAAs):
  - based on recent lending patterns, about one-quarter of large bank mortgage lending and nearly 40 percent of small business lending that is outside of FBAs would be evaluated for the first time in RLAs
  - exempts banks with branch-based business models (banks with 80 percent or more of retail lending within facility-based assessment areas)
  - increases the loan count thresholds that would trigger RLAs (from 100 to 150 closed-end home mortgage loans, and from 250 to 400 small business loans)
- reduces the number of product lines potentially evaluated in RLAs: home mortgage loans or small business loans are only evaluated if the specific product line meets the triggering thresholds; other product lines are not evaluated in RLAs
- based on agency analysis of 2018–20 CRA historical data, the agencies estimate that the changes described above would reduce by about half the number of large banks that would be required to delineate RLAs and the number of RLAs that would be created based on prior year lending. The approach would still evaluate banks with significant concentrations of retail loans outside facility-based assessment areas

### **4. Adds metric and impact factor to evaluate bank CD investments under the CD Financing Test.**

- adds additional metric to CD financing evaluations, focusing on certain CD investments relative to deposits for banks greater than \$10 billion, to enable examiners to evaluate bank investments under the Low-Income Housing Tax Credit and the New Markets Tax Credit programs. Strong bank performance under the metric would be a basis for positive consideration.
- creates an impact factor to recognize the important affordable housing and community development contributions of Low-Income Housing Tax Credit and New Markets Tax Credit investments

### **5. Provides additional flexibility under the strategic plan option while continuing to meet the credit needs of communities.**

- clarifies the option for any bank to request evaluation under a strategic plan and provides additional flexibility for banks with nontraditional business models
- strategic plans would need to reflect community input and meaningfully reflect that the bank seeking a plan will continue to meet the credit needs of communities if the plan diverges from the otherwise applicable performance tests

**6. Addresses feedback on the need to have additional time for banks to implement the new rule.**

- increases the amount of time for banks to come into compliance with the new requirements (from 12 months to more than 24 months after the rule is adopted and published on the agency websites), balancing industry requests for additional time and the objective of implementing the regulations in a timely manner

**7. Retains and clarifies the provision on CRA ratings downgrades.**

- for CRA ratings downgrades, maintains the current standard for “discriminatory or other illegal credit practices” rather than both credit and non-credit practices as proposed

**8. Ensures consideration of certain small business loans under the economic development category of community development.**

- for certain loans to small businesses that meet a size and purpose test, allows consideration as a community development loan under economic development in addition to evaluation as a retail loan

 [PDF Version](#)

March/April 2024

# Compliance Meets AI

A Banking Love Story

BY SAM HOLLE, JD, CRCM, AND KRIS STEWART, JD, CRCM



STOCK.ADOBE.COM / FRESHIDEA / RARINLADA / VLAD KOCHELAEVSKIY

**We decided to ask ChatGPT to help us write an introduction to this article.**

**Q:** We're writing an article for a banking risk and compliance magazine on large language models. Tell us a fun fact about you that would encourage compliance officers to want to use you.

**A:** *Fun fact: As a large language model, I can significantly streamline and enhance the compliance process for banking professionals. Compliance officers can leverage my capabilities...*

**Not what we hoped for, so, we tried again.**

**Q:** Can you be a little more succinct and fun?

**A:** *Certainly! Fun fact: I'm your compliance co-pilot, navigating the complex terrain of banking regulations with lightning speed and precision. I'm the Swiss Army knife for compliance officers, simplifying searches, drafting documents, and keeping you on the straight and narrow in the exciting world of banking compliance!*

**Better right? And we could not leave well enough alone – so –**

**Q:** That's good. How about a catchy title for the article?

**A:** *"Compliance Revolution: How Large Language Models are Transforming Banking Regulation"*

**Q:** Too long and not fun. Do you have something shorter and pithier?

**A:** *"Compliance Meets AI: A Banking Love Story"*

Nailed it! We promise, from here on out, the writing is all human!

## **Generative AI: What You Need to Know**

Rarely does a day go by without our news feeds reporting on the rapidly evolving world of Generative AI (GAI)—artificial intelligence that can generate text, images, or other media in response to prompts. GAI models, and more specifically large language models (LLMs), a type of GAI, are being deployed across industries and



financial institutions are thinking of ways they can do so, too—a challenge made all the greater by being highly regulated entities. Larger financial institutions are developing their own solutions, and of course vendors are rapidly figuring out ways to use this technology in their solutions.

So, what exactly are LLMs and why should you become familiar with them? LLM's, like ChatGPT and Bard, are models that are trained on vast amounts of textual data such as books, articles, white papers—anything you can find on the internet. The models recognize patterns and relationships in human language. They take that learning to generate text in response to your question (called a prompt in the AI world). Based on the vast data upon which they are trained; they answer your prompt based on predictive analytics—determining the most logical word or phrases in response to your question.

## **Risks Associated with GAI Technology**

If you like to keep an eye on technology news, you have likely seen reports of some spectacular "fails" when it comes to the use of LLMs. Take for example, the attorney who submitted a brief to a court, citing cases, complete with quotes, citations, and judge's names. The only problem was that ChatGPT made them up. This type of inaccuracy is known in the AI world as "hallucination."

Hallucination is a tendency of a LLM to "make up facts," drawn from the many terabytes of data they have been trained with, to produce very convincing answers to prompts. Hallucination can result because LLMs are trained to be predictive, based on word patterns—with the goal of being conversational vs strictly knowledgeable.

The good news is that while hallucinations cannot be eliminated, they can be minimized and mitigated. LLM developers have been quick to respond to reported epic failures in their models to provide more safeguards in the results produced. OpenAI, the company behind ChatGPT, has initiated a new methodology that it refers to as "process supervision" that is intended to evaluate each logic step in the model's method for answering a prompt and, in doing so, to help detect and mitigate a model's logical mistakes. Also, controlling the data sources the model is trained on by using domain-specific, trusted data sources can provide better results. Ultimately, there is no substitute for expert (human)

verification of the results.

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“ Roleplaying and chain-of-thought promptings are just two prompt engineering tips. There are dozens of other good ones just a quick web search away.

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## Better Answers Through Better Questions

Another way to mitigate hallucination is to provide better context via prompt engineering. Prompt engineering refers to the practice of composing your question such that the system provides a more accurate answer. Using traditional search engines, we are used to asking very sparse questions and getting reasonable answers; those same queries do not work well as LLM prompts.

Researchers have identified best practices that produce much more accurate results. A couple of techniques that are useful are Roleplaying and Chain of Thought. Roleplaying refers to explicitly assigning a role to the chatbot: "You are an experienced compliance officer writing policies and procedures for a bank" or "analyze this case like Harvard Law Professor Cass Sunstein." The idea is to give the chatbot a lot of context. It is helpful to think of chatbots as new college interns: very smart but requiring guidance to produce quality work.

Another useful technique is called chain-of-thought prompting. All you need to do is add the phrase "think step by step" to the end of a prompt. When you do so, the bot will explain the steps in its reasoning, which is essential for double-checking the work. It also leads to better results, which will not be any surprise to math teachers who have been admonishing students to show their work for centuries.

Roleplaying and chain-of-thought promptings are just two prompt engineering tips. There are dozens of other good ones just a quick web search away. While AI is rapidly improving at discerning what the questioner is looking for, there is still value in experimenting with learning how to write better prompts.

## Opportunities Abound

Most financial institutions are at preliminary stages in evaluating opportunities to use Generative AI in their operations. Some of the areas where we are seeing the anticipated use of LLMs are in customer services. Large language models can interact with a bank's customers in very natural conversations. Depending on the data that the bank trains the LLM on, the chat bots can answer questions about customer accounts and even provide recommended product offerings and investment advice. Several large banks are working with internal LLM models to capture call center notes, organize information for investment advisors and organize other product data for customer service reps, with plans to roll out to more customer-facing uses as extensive testing addresses potential risks.

Banks are also assessing opportunities to improve internal operations. Generative AI capabilities enable new ways to analyze data. One practical use case for most organizations is to train LLMs on all the pockets of organizational information that employees need to access to do their jobs. Imagine spending less time looking for things and more time solving problems, with the information you need, quickly presented to you via an interactive chat with your friendly LLM bot.

LLMs also lend themselves to reading large regulatory documents and providing structured responses to aid a compliance or risk professional in digesting complex regulations and locating practical implementation guidance. The recent publication of the Small Business Lending rule by the CFPB illustrates these challenges. Between the regulation (complete with preamble and commentary) and the supplementary documents, there are over 1,200 pages of material to read and digest. A large language model, with structuring guidance from a legal expert, can digest all this material and provide useful responses to staff charged with understanding the regulation and producing policies, procedures, and implementation plans.

## Yes, There's Risk

The continuing, rapid evolution of technology means that the opportunities for new and creative uses will continue to grow. According to a study from McKinsey, across the banking industry, GAI could deliver value equal to an additional \$200

billion to \$340 billion annually if the use cases were fully implemented. <sup>1</sup> With that kind of economic potential in the industry, we compliance and risk professionals need to start now to learn more about this technology and how to help manage risk for our organizations.

Regulators are also raising concerns that are important to address. Concerns around privacy of customer data, bias in algorithms and other UDAP/UDAAP concerns are on their minds. CFPB Director Chopra has reiterated that there are a wide range of potential threats to consumers' civil rights, and he reminds us that "there is no exemption in our nation's civil rights laws for new technologies that engage in unlawful discrimination. Companies must take responsibility for their use of these tools." <sup>2</sup>

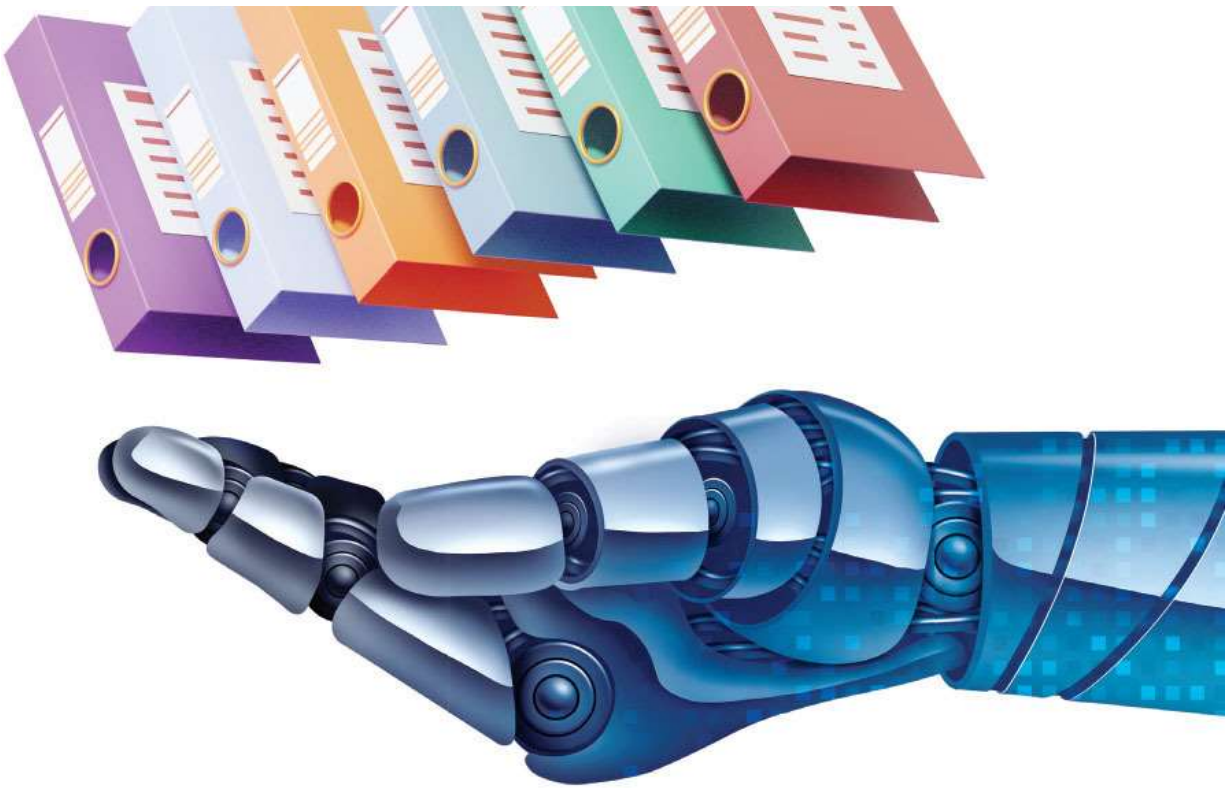
Other institutional risks can result from employees using public versions of LLMs. When ChatGPT burst on the scene in late 2022, many of us logged on and were amazed at how it could author poems, suggest birthday party ideas for a nine-year-old, and devise creative holiday cocktail names. Then we started thinking about how it could help us with work. Helping draft emails, write a performance review, or suggest some creative marketing ideas for our yet-to-be-launched product. While it might seem harmless on the surface, you are exposing trade secrets and creating privacy concerns for your organization. It is important to read the fine print. Many existing chatbots have terms of service that allow the company to reuse user data to "develop and improve" their services.

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“Generative AI capabilities enable new ways to analyze data. One practical use case for most organizations is to train LLMs on all the pockets of organizational information that employees need to access to do their jobs.”

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A critical early step is to develop and implement an acceptable use policy. While many of your existing policies should apply to employee use of public LLMs, with the rapid evolution of this technology and the attraction it generates, it is better to be direct on what actions are permissible. It may not be obvious to someone using a public chat bot that they are exposing confidential information. So, an explicit policy that clearly states what your staff can and cannot do with LLMs is a prudent early step. Having employees acknowledge the policy and taking training courses on it are possible next steps.

## Regulation on the Horizon

Nearly 200 AI-related bills were introduced in 31 different states this year according to the Business Software Alliance.<sup>3</sup> It is expected that 2024 will see even more activity. These bills respond to concerns about misuse of AI—including its ability to create fake images and audio "deepfakes"—and seek to define and put safeguards around AI's role in employment and credit decisioning. California has taken the lead with two agencies, the California Civil Rights Council and the California Privacy Protection Agency, in seeking to regulate automated decision-making.<sup>4</sup> Reviewing AI through the lens of privacy may seem surprising, but it is [106](#)

part of a long-running trend of technological change prompting expanded conceptions of privacy. There was not a need for a "right of publicity" until photography was invented. Nobody conceived of a "right to be forgotten" until the cost of documenting and archiving every youthful indiscretion became essentially free.

At the federal level, Senator Charles Schumer in September 2023, held the first of nine A.I. Insight Forums. These are closed-door events where tech leaders, such as Sam Altman, Bill Gates and Elon Musk, together with tech ethicists such as Tristan Harris and Dr. Rumman Chowdhury, addressed the assembled senators to explain the technology and their concerns for the future.<sup>5</sup> Notably, when Sen. Schumer asked the panel whether the government should regulate A.I., every hand was raised.<sup>6</sup>

While there may be broad agreement that regulation is needed, the federal government's recent track record for regulating technology does not inspire confidence that D.C. will get the job done. "We've yet to pass a meaningful bill, for example, protecting people's privacy on social media," said Sen. John Neely Kennedy (R-La.). "If we can't do it for an important ... but less difficult issue like protecting privacy on the internet, I think artificial intelligence will be tougher."<sup>7</sup>

And finally, on October 30, 2023, President Biden issued an executive order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence. The order lays out eight guiding principles and priorities, and tasks federal regulatory agencies to use these to advance and govern AI development. The overarching goal is to encourage responsible AI development while still creating a governing environment to mitigate the substantial risk. Financial services, as part of the critical infrastructure as defined by the Patriot Act, will be impacted by the regulatory activities that will emerge from this order.

## Conclusion

How do you wrap up a banking love story? (You remember the title, right?) Generative AI will change so much about how we function in the world in the months and years to come. Like many great love stories, only time will tell how the relationship between Compliance and AI evolves. However, there is no time like the present to learn about Generative AI and the opportunities and risks that

like the present to learn about generative AI and the opportunities and risks that will need to be managed. Enjoy the journey.

## ABA MEMBER RESOURCES

### ABA Webinar: Tech Innovation and AI

[aba.com/training-events/online-training/tech-innovation-and-ai-managing-risk-in-the-rapidly-evolving-landscape](https://aba.com/training-events/online-training/tech-innovation-and-ai-managing-risk-in-the-rapidly-evolving-landscape)

### ABA Advocacy: Executive order on artificial intelligence

[aba.com/advocacy/policy-analysis/eo-artificial-intelligence](https://aba.com/advocacy/policy-analysis/eo-artificial-intelligence)

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## Endnotes

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COMPLIANCE & RISK

# Where AI will play an important role in governance, risk & compliance programs

**Todd Ehret** Senior Regulatory Intelligence Expert

24 Aug 2023 · 6 minute read

Artificial intelligence has an important role to play in corporations' governance, risk management, and compliance efforts, especially around areas of fraud detection and

## protection

Artificial intelligence (AI) has emerged as a new fascination and topic of discussion in countless areas of society and businesses, across virtually all industries. Although generative AI could assist with the challenging tasks of drafting and maintaining internal documents and policies, other forms of AI or machine learning are already being incorporated into countless other areas related to risk and compliance.

Governance, risk management, and compliance (GRC) software platforms are vital tools used by almost all compliance and risk departments — and these will be at the core of AI. Historically most businesses practiced these areas separately; now however, GRC platforms combine various software programs and datasets into one coordinated platform, which can help companies increase efficiency, reduce noncompliance risk, and share information more effectively.

Indeed, AI is finding its way into GRC platforms in ways far more complex and well beyond the use of large language models (LLMs) or chatbots that can answer questions or help draft policies.

## Potential AI use cases

The list of areas ripe for AI-based improvements is endless. Areas specific to compliance include regulatory change management, horizon scanning, obligation libraries, policy management, control management, third-party risk management, anti-money laundering (AML), know-your-customer (KYC) obligations, enhanced detections, and monitoring capabilities, to name just a few.

Many GRC software solutions offer advanced capabilities for quickly identifying and harmonizing risk and control libraries; locating missing relationships between risks, controls, and processes; and proactively identifying issue trends, emerging risks, and control failures. Adding AI to these programs will make them even more powerful.

Some of the key improvements and benefits of adding AI to GRC platforms include:

- detection of risk, audit, and control deficiencies;
- detection of duplicate risks and controls;

- detection of patterns of over-testing and under-testing of controls;
- potential reduction of false positives, which is valuable in AML/KYC applications; and
- predictive planning and prioritization of risk assessments.

There are many use cases for AI, and no single solution covers everything. However, incorporating AI across a GRC architecture that scans multiple data sets and systems offers incredible potential for improvements in various areas of risk and compliance, including:

**Horizon scanning** — AI can be used to better scan and evaluate pending legislation, proposed rules, enforcement actions, speeches, and public comments made by regulators to detect future risks and concerns.

**Obligation libraries and regulatory change management** — AI can better monitor current regulatory obligations and notifications while comparing and tracking regulatory changes and notifications to help stay current. Many financial institutions receive hundreds of daily change alerts, which must be manually reviewed, prioritized, and delegated. AI can dramatically improve this process by improving reaction and adoption times, which could minimize fines and compliance risks.

**Policy management** — AI will help map regulations and change management and coordinate it with an organization's current policies and procedures. It will better detect gaps and necessary policy changes, and it may also suggest language for the updates to fill such gaps.

**Internal controls, finance risk, and resilience management** — AI offers the potential to integrate and improve other aspects of businesses, including finance and internal controls. Often legacy systems that are currently being used are independent and siloed; yet incorporating them into a more holistic GRC platform and adding AI will improve them. Efforts to evaluate and optimize controls using AI can provide insight into the effectiveness of controls by analyzing data and identifying trends. Detecting control failures, those most likely to fail, or duplicate controls, also can identify weaknesses and save costs.

## Additional areas ripe for AI improvement

Beyond change-management, AI will dramatically alter third-party and vendor-risk management, cyber and IT risk management, and other areas, such as in financial risk, environmental, social & governance (ESG), and AML/KYC functions.

From a cybersecurity perspective, the growing frequency, complexity, and sophistication of cyber-threats make enhanced defense capabilities a necessity. AI-powered or -enhanced defense efforts can help organizations augment their cyber-capabilities through advanced threat detection, predictive analytics, and real-time monitoring. Continuous AI monitoring in coordination with relevant regulations can help firms better comply with applicable IT, privacy, and cyber-regulations.

Banks and financial institutions can use AI to leverage large, complex data sets and better detect and understand risk models that may also be more accurate than historical models that are based on standard statistical analysis. An effective AI tool may also scan and identify patterns and potential causes of risk events and recommend controls to mitigate such risks.

From an AML/KYC or financial crime perspective, AI can better scan for sanctioned or politically exposed persons, detect suspicious activity, and better *connect the dots* across multiple data sets. AI can also analyze more volumes of financial data and customer behavior patterns to identify suspicious activity.

Most importantly, from a financial crime or AML perspective, AI's ability to decrease *false positives* and do it quicker than the manual process can be an enormous cost savings for an organization.

Finally, generative AI provides the ability to ask difficult questions and receive plain language answers, which could minimize risks and improve communications between senior executives, such as chief technology officers (CTOs), chief information security officers (CISOs), and their organizations' boards of directors.

## AI challenges and best practices

AI will be transformative in many businesses, but it will require its own compliance policies and procedures, because the technology poses ethical, legal, and compliance risks when not appropriately governed.

However, AI's benefits, particularly from a risk mitigation perspective, outweigh its risks and consequences. Regulations and laws surrounding AI are presently scarce and in their infancy, but more complex laws and regulations are inevitable and will require thoughtful governance by organizations.

The challenge will be to create internal policies, procedures, and oversight mechanisms to harness AI effectively. To this end, some best practices, policies, or concepts to consider surrounding AI include appointing a dedicated AI leader like a CISO or, at a minimum, creating a senior working group that includes an AI ethicist.

Firms should also map all uses of AI in their organizations and adopt a set of governing principles, intended benefits, and risks. AI systems should also be transparent and fully explainable and understandable. And they should also be continuously tested, validated, and monitored — and this process should be thoroughly documented.

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## Solutions

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# The Impact of AI-Generated Synthetic Fraud on Finance

ON JANUARY 1, 2024

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Fake people are having a major impact on our real world. AI technology has empowered even the most elementary of fraudsters with sophisticated tools that allow them to piecemeal real-looking identities, creating havoc for businesses across all verticals. The rise of AI-generated fake identities poses a serious threat to the integrity of financial systems, with consequences extending into the realms of politics and society. Synthetic fraud, the creation of fabricated identities using personal information from real individuals, is on the rise, with potential financial losses in the billions.

### NEWSBYTES

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- MAR 11 FDIC's Hill criticizes policy approach to digital assets, FHLB lending
- MAR 11 Wall Street Journal: White House playing 'whack-a-bank' with late fee rule

Despite substantial investments in fraud prevention, financial institutions are struggling to combat synthetic identity fraud, where AI is used to create fake identities, engaging in activities like opening lines of credit, checking bank account balances, or making small deposits. The ability to create images and convincing audio files complicates the issue, enabling the creation of deepfakes that deceive even the most discerning individuals.

A [recent report](#) from Wakefield Research highlights the ongoing struggles financial services organizations face in their battle against synthetic identity fraud. Despite having existing solutions, these organizations find themselves under constant assault from fraudsters armed with AI technology. The sophistication of these fraudsters is rising, making it challenging for institutions to keep pace.

The report reveals disturbing trends, with synthetic accounts seamlessly engaging in common financial activities to avoid detection. Shockingly, a significant percentage of surveyed companies have unwittingly extended credit to these fake personas, resulting in substantial financial losses.

The emergence of AI-generated [Super Synthetic](#) identities adds another layer of complexity to the ongoing battle against financial fraud. As synthetic identity fraud becomes more agile and sophisticated, the need for advanced detection methods becomes increasingly important. Professionals in the field are already expressing concern over the criminals' increasing ability to evade detection, with [over half](#) believing that AI-generated fraud will worsen before effective preventive measures are implemented.

Leaders in the financial sector must stay vigilant and adopt innovative technologies swiftly to mitigate the risks posed by synthetic identity fraud. A proactive stance is essential to prevent irreversible damage to financial institutions and their customers.

The integration of multi-contextual, real-time data at a massive scale has proven useful in detecting signs of AI-generated identity fraud. This is because activities that make a synthetic account appear

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legitimate leave digital footprints that can give them away. A zoomed-out view of an account’s digital activity can expose the real person behind it—or reveal when there is no such person.

Given that synthetic identity fraud was [already the most common form of identity fraud in the US](#), the prospect of fraudsters becoming more agile and effective is a sobering one. If the technology and methodology to detect and root out these synthetic identities before they can do damage isn't agile or advanced enough to detect patterns of activity that are matched to another identity – financial institutions will keep paying the price.

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February 21, 2024

## Deepfakes and the Use of AI in Cyberattacks

Bridget Quinn Choi, Esq.

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The headlines about a \$25 million wire transfer fraud employing deepfake technology have rightfully given chief financial officers and finance departments considerable pause. The attack began with a phishing email delivered to the victim’s finance employees in mid-January, luring them with information about a “secret transaction.” One of the members of the finance team clicked on the link—and so began the elaborate deception.



The attacker invited the employee to a video conference, presenting a convincing deepfake simulation of the CFO and other colleagues. The employee believed the request to carry out a secret transaction was legitimate, and because of the quality of the deepfake video, the employee was moved to act. The employee ultimately transferred the equivalent of \$25.6 million to five different bank accounts through 15 transactions, following the fake colleagues' instructions.

The term “deepfake” refers to a multimedia that either has been synthetically created or manipulated using some form of machine or deep learning from the engine of artificial intelligence.

The deepfake media is highly realistic and therefore highly convincing and effective in a social engineering attack. In the incident discussed above, the cybercriminals used deepfake technology to impersonate an influential person within the organization, gain access and communication within the network—and served as a mode of deception to facilitate the theft of millions of dollars.

The tactics used by cybercriminals to defraud an organization remain the same; social-engineering attacks like this are nothing new. What has changed in the advent of AI-enabled deepfakes is the ease and scale in which a cybercriminal can manipulate multimedia and launch a convincing attack. These technological advances will allow cybercriminals to increase the frequency and the rate of success of social engineering attacks. However, organizations can implement a variety of strategies to build resilience to wire transfer fraud loss.

## **Build a Layered Cyber Defense**

The tools criminals use to trick and defraud will evolve over time. However, a layered defense based on basic cyber hygiene principles may have prevented or mitigated this attack. The cybercriminal initially gained access to the organization through a phishing email. Here are some basics that can be implemented to protect against a phishing attack:

- 1) Train employees to spot phishing emails** and regularly test employees on the training.
- 2) Provide a phishing reporting button on the organization’s email platform.** The button serves as an easy and obvious way to report suspected phishing attempts and furthers the corporate culture of cyber awareness

and action.

**3) Invest in an email scanning solution.** Several tools on the market protect against phishing attempts. They typically include features that detect malicious links and attachments and remove them or render them safe using advanced methods like sandboxing.

**4) Abide by industry standards** like Sender Policy Framework (SPF), DomainKeys Identified Mail (DKIM), and Domain-Based Message Authentication, Reporting, and Conformance (DMARC). Each is intended to fight the prevalence of spam by allowing receiving email servers to authenticate the servers they receive mail from. These standards ensure that mail servers claiming to send on behalf of the organization's domain are authorized to do so.

Building a layered cyber defense means creating secondary safeguards that work together to bolster network security and mitigate a single point of failure throughout the network. While a cybercriminal may be able to trick an employee into clicking on a link in a phishing email, a second layer of defense is building a payment fraud detection strategy.

### **Build a Payment Fraud Detection Strategy**

Building controls around payments and fund transfers is essential to corporate risk management. Despite the criminals' use of AI technology in this case, thoughtful controls can prevent the most compelling attempts to defraud.

#### **Educate those with access to funds on the risks:**

- **Apply the highest-level scrutiny to unexpected wire transfer requests. It is the most common pattern in fraudulent funds transfers.** Create an iron-clad set of controls around unexpected wire transfers. Also, educate finance teams on common schemes to help build resilience to phishing schemes.

- **Beware of bogus “problems” or account issues.** Enforce rules regarding wire funds to fix a supposed account problem. Legitimate financial institutions will never request a wire to resolve an account issue. Account teams should be educated so they can spot abnormal business practices and apply appropriate scrutiny to the transaction.
- **Caution against overpayment schemes.** If accounting receives a check followed by a demand to wire back excess funds, the check is likely bogus, and the request is an attempt to defraud.

### **Criminal tactics will continue to evolve. Build a practice of multi-point verification for wire transfers:**

- Require out-of-band verification for each wire transfer.
- Set a rule prohibiting sending wire instructions via email.
- Require two points of approval (and verification) for large transfers or multiple transfers to one entity.
- Invest in wire transfer fraud prevention software.

Aligning an organization’s operational, financial, and security objectives is essential to building resilience to wire transfer fraud.

### **Build a Response Plan**

If an organization detects and reports a fraudulent wire transfer to law enforcement within 72 hours, the Financial Fraud Kill Chain (FFKC) may be used to stop the transfer.

The FBI created the Financial Fraud Kill Chain in 2016 to assist law enforcement in quickly identifying and stopping suspicious wire transfers from going to offshore accounts, which are almost impossible to recover. To use this tool, victims must be prepared to act:

- Create a response plan with designated roles and responsibilities in the event of a cyber event that results in misdirected funds.
- Create a contact list that includes internal contacts, the organization's financial institution, the local FBI office and/or a contact at the Secret Service, and [the website for filing an IC3 report](#).
- Clearly identify who needs to take each specific step.
- Be ready to execute the response plan and authorize those with responsibilities to carry it out.
- Review the plan regularly and update it as needed.

Preventing wire transfer fraud requires thoughtful planning and a combination of fraud risk management and cyber risk management. But what happens if all the planning and prevention fails, and we have a novel attack using innovative technology like AI-enabled deepfakes? In this case, insurance is the risk transfer solution you need.

## **Ensure Appropriate Cyber Liability Insurance Coverage for the Risk**

No uniformity exists when it comes to coverage for wire transfer fraud in the [cyber liability insurance](#) market. Many cyber insurance carriers do not provide a coverage grant for the loss of funds or sublimit the coverage offered. Additionally, many carriers may require, as a condition of coverage, that the policyholder has and follows internal controls on payments. Failure to follow internal controls in making a payment or wire transfer could result in restrictions on limits and scope or a denial of coverage.

Some grants of coverage may be too narrow and may not include the evolving types of trickery used by criminals, like the AI-generated deepfake. Work with your cyber broker team to identify the appropriate cyber insurance policy and limits. You can also work with a fraud and cyber risk consultant to build your controls, so you are prepared to thwart, contain, and respond to this evolving risk.


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[Final rule \(cfpb.gov/rules-policy/final-rules/?categories=final-rule\)](https://cfpb.gov/rules-policy/final-rules/?categories=final-rule)

# Fair Credit Reporting; Background Screening

The Consumer Financial Protection Bureau is issuing this advisory opinion to affirm that, when preparing consumer reports, a consumer reporting agency that reports public record information is not using reasonable procedures to assure maximum possible accuracy under section 607(b) of the Fair Credit Reporting Act (FCRA) if it does not have procedures in place that: (1) prevent reporting information that is duplicative or that has been expunged, sealed, or otherwise legally restricted from public access; and (2) include any existing disposition information if it reports arrests, criminal charges, eviction proceedings, or other court filings. This advisory opinion also highlights that, when consumer reporting agencies include adverse information in consumer reports: (1) the occurrence of the adverse event starts the running of the reporting period for adverse items under FCRA section 605(a)(5); (2) that period is not restarted or reopened by the occurrence of subsequent events; and (3) a non-conviction disposition of a criminal charge cannot be reported beyond the seven-year period that begins to run at the time of the charge. Consumer reporting agencies thus must ensure that they do not report adverse information beyond the reporting period in FCRA section 605(a)(5) and

## RULE DETAILS

Date issued by CFPB

JAN 11, 2024

Effective date

Effective as of date of publication  
in Federal Register

## Topics

- [FAIR CREDIT REPORTING ACT](https://cfpb.gov/rules-policy/final-rules/?TOPICS=FAIR-CREDIT-REPORTING-ACT) (CFPB.GOV/RULES-POLICY/FINAL-RULES/?TOPICS=FAIR-CREDIT-REPORTING-ACT)
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## EMAIL UPDATES



must at all times have reasonable procedures in place to prevent reporting of information that is duplicative or legally restricted from public access and to ensure that any existing disposition information is included if court filings are reported.

## FINAL RULE

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[Privacy Act Statement](https://www.consumerfinance.gov/privacy/general-request-inquiry-privacy-act-statement/) (https://www.consumerfinance.gov/privacy/general-request-inquiry-privacy-act-statement/)

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## FURTHER READING

### Blog

[Servicemembers continue to face major financial challenges](https://cfpb.gov/about-us/blog/servicemembers-continue-to-face-major-financial-challenges/) (cfpb.gov/about-us/blog/servicemembers-continue-to-face-major-financial-challenges/)

NOV 01, 2023

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[CFPB Director Rohit Chopra Releases a Statement in Response to President Biden's Executive Order To Protect Americans' Sensitive Personal Data](https://cfpb.gov/about-us/newsroom/cfpb-director-rohit-chopra-releases-a-statement-in-response-to-president-bidens-executive-order-to-protect-americans-sensitive-personal-data/) (cfpb.gov/about-us/newsroom/cfpb-director-rohit-chopra-releases-a-statement-in-response-to-president-bidens-exec

[Final rule \(cfpb.gov/rules-policy/final-rules/?categories=final-rule\)](https://cfpb.gov/rules-policy/final-rules/?categories=final-rule)

# Fair Credit Reporting; File Disclosure

The Consumer Financial Protection Bureau is issuing this advisory opinion to address certain obligations that consumer reporting agencies have under section 609(a) of the Fair Credit Reporting Act (FCRA). This advisory opinion underscores that, to trigger a consumer reporting agency's file disclosure requirement under FCRA section 609(a), a consumer does not need to use specific language, such as "complete file" or "file." This advisory opinion also highlights the requirements regarding the information that must be disclosed to a consumer under FCRA section 609(a). In addition, this advisory opinion affirms that consumer reporting agencies must disclose to a consumer both the original source and any intermediary or vendor source (or sources) that provide the item of information to the consumer reporting agency under FCRA section 609(a).

## FINAL RULE

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- [FAIR CREDIT REPORTING ACT](https://cfpb.gov/rules-policy/final-rules/?TOPICS=FAIR-CREDIT-REPORTING-ACT) (CFPB.GOV/RULES-POLICY/FINAL-RULES/?TOPICS=FAIR-CREDIT-REPORTING-ACT)
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## EMAIL UPDATES



# Year-End Report Reveals Increased TCPA Filings and CFPB Complaints in 2023

[Blog](#) Consumer Financial Services Law Monitor

**Troutman Pepper**

MEMBER FIRM OF **LexMundi**

**USA** | January 31 2024

According to a recent year-in-review report by WebRecon, reversing the trend of the last two years, filings under the Telephone Consumer Protection Act (TCPA) increased in 2023 as compared to 2022. Likewise, complaints filed with the Consumer Financial Protection Bureau (CFPB) were up for the year. Fair Credit Reporting Act (FCRA) and Fair Debt Collection Practices Act (FDCPA) filings, however, were both down from the previous year. In all, the FCRA maintained its lead in the number of filings, followed by the FDCPA, and with the TCPA in third place.

WebRecon reports the overall statistics for consumer litigation throughout 2023 as follows:

- 5,587 FCRA cases were filed, representing a 0.9% decrease from 2022;
- 4,165 FDCPA cases were filed, representing a 8.2% decrease from 2022;
- 1,683 TCPA cases filed, representing a 9.4% increase from 2022; and
- 68,706 complaints filed with the CFPB, representing a 2.1% increase from 2022.

Focusing specifically on the month of December 2023, the report indicates that FCRA, FDCPA, and TCPA filings each decreased from the previous month by 14.1%, 0.3% and 4.3%, while CFPB complaint filings increased by 9.4%.

**Troutman Pepper** - David N. Anthony and Alan D. Wingfield

## FACT SHEET

# Final Rule on Simplification of Deposit Insurance Rules for Trust and Mortgage Servicing Accounts

*The Federal Deposit Insurance Corporation (FDIC) approved a final rule to amend the deposit insurance regulations for trust accounts and mortgage servicing accounts. The final rule will take effect on April 1, 2024, providing depositors and insured depository institutions more than two years to prepare for the changes in coverage.*

### SIMPLIFIES DEPOSIT INSURANCE RULES FOR TRUST ACCOUNTS

- To make the deposit insurance rules easier to understand for depositors and bankers, the rules currently used to determine coverage for deposits of revocable trusts and irrevocable trusts – which are different for the two types of trusts – will be replaced with a simpler common rule.
- A deposit owner's trust deposits will be insured in an amount up to \$250,000 for each of the trust beneficiaries, not to exceed five, regardless of whether a trust is revocable or irrevocable, and regardless of contingencies or the allocation of funds among the beneficiaries.
- This will provide for a maximum amount of deposit insurance coverage of \$1,250,000 per owner, per insured depository institution for trust deposits.
- The final rule is also intended to facilitate more timely deposit insurance determinations for trust accounts in the event of a bank failure by streamlining the detailed, time-consuming review of trust agreements that is often required under the current, complicated trust rules.

### ENHANCES CONSISTENCY FOR MORTGAGE SERVICING ACCOUNT DEPOSITS

- The deposit insurance rules for mortgage servicing accounts comprised of principal and interest funds currently provide coverage based on each mortgagor's payments of principal and interest into the mortgage servicing account, up to \$250,000 per mortgagor.
- Some servicers advance their own funds to the lenders on behalf of borrowers. Under the current rule, such advances are not provided the same level of deposit insurance coverage as other deposits in a mortgage servicing account comprised of principal and interest payments directly from the mortgagors.
- Under the final rule, servicers' advances of principal and interest funds on behalf of mortgagors would be insured up to \$250,000 per mortgagor, consistent with the coverage for payments of principal and interest collected directly from mortgagors.

###

# Rising Tides and High Water

The Latest in Flood Compliance and Risk Management

BY KATHRYN MORRIS, J.D., CRCM



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**C**OMPLIANCE WITH THE FLOOD DISASTER PROTECTION ACT (FDPA) has often felt like treading water—mostly sustainable once you learn how to do it efficiently, yet it always carries the risk of an undertow. Though the requirement to insure for flood risk often applies to only a small portion of a regulated financial institution’s (FI’s) loan portfolio, the shifting currents and sometimes raging waters of flood compliance continue to be a perennial source of risk. This article pools together some of the industry’s most salient challenges and risk mitigation opportunities in our current climate. Let’s wade in!


**Navigating Risk Rating 2.0**

In October of 2021, the Federal Emergency Management Agency (FEMA) began using new pricing methodology for policies issued through the National Flood Insurance Program <sup>1</sup> (NFIP). Dubbed "Risk Rating 2.0", this new approach was implemented in order to increase equity in flood insurance premium costs by considering the specific details of the subject property in premium calculation. Whereas previous pricing was based entirely on the property's location and its associated zone within a Flood Insurance Rate Map, the new approach factors in a building's particular characteristics, specific elevation, and distance from a source of water.

As of April 1, 2023, FEMA has completed its phased-in implementation, and all new and existing NFIP policies are subject to Risk Rating 2.0. <sup>2</sup> These changes have impacted how FIs treat flood zone investigations, and may influence how we think about the flood insurance premium as a variable in our dealings with clients.

### ***Do Flood Zones Still Matter?***

Flood maps, zoning, and risk ratings have long been at the center of a Compliance Officer's interaction with flood insurance. Historically, FIs have been cited for inadequate insurance when the flood zone on the determination did not match the zone rating on the policy. Accordingly, for many years, the role of Compliance has been to ensure that flood review controls were inclusive of this requirement, but Risk Rating 2.0 methodology has simplified this process.. The Interagency Q&As <sup>3</sup> released in 2022 have clarified that FIs need not reconcile the determination zone with any policy risk ratings. <sup>4</sup> This is both because the flood zone no longer correlates directly with the insurable risk to the property, and declarations pages no longer contain zone information except in certain private policy cases. (For more information on the Q&As, see The Final Flood Q&As are Here!, in the November–December 2022 issue.)



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Flood zones are still relevant for determining whether a property exists within a Special Flood Hazard Area (SFHA) and therefore triggers the mandatory purchase requirement, so FIs may still encounter disagreements with clients as to the zone rating that applies to their property. In this case, the Q&As indicate that the FI and the client should seek resolution. If a resolution cannot be achieved, the familiar appeal mechanisms of the Letter of Map Amendment and other instruments may be utilized in order to achieve certainty. <sup>5</sup>

### ***Rising and Receding Premiums***

Risk Rating 2.0 methodology generally means that borrowers can now get consideration of their specific flood mitigation efforts and the nuances of their landscape as it relates to the active flood zone. However, for borrowers in flood-vulnerable regions or localities, flood insurance may get more complicated, more expensive, and potentially have longer term impacts. This is because premiums may increase over time in ways that borrowers have not previously experienced,

which may impact the client's ability to repay during the life of their loan.

This method of risk rating means that premiums may increase over time in ways that borrowers have not previously experienced, which may impact the client's ability to repay during the life of their loan. Analysis during underwriting is based on flood insurance premiums in effect at the time of origination, consequently, if the borrower's ability to repay was marginal based on those numbers, increasing premiums may directly impact their ability to keep their head above water. Banks should consider monitoring for premium increases, flood risks within their footprint, and default rates within the flood portfolio. A potential mitigant for the risk of increasing premiums is to educate borrowers on the importance of maintaining existing policies without lapse, as doing so may be key to maintaining previously locked in rates before the application of Risk Rating 2.0 methodology on premiums.

## **Risky Tributaries and Waterfalls of Enforcement**

Recent enforcement action activity has served to remind the industry of the importance of compliance voices in change management protocols and third-party risk management, especially when they are connected to flood insurance and related processes. The two most prominent enforcement actions within the last few years demonstrate the need for comprehensive controls and monitoring.

In January of 2020, the industry saw one of the most costly flood insurance enforcement actions ever issued when a large institution was fined nearly \$18 million for a pattern and practice that allowed its third-party flood monitoring vendor to extend the 45-day force placement notice period.<sup>6</sup> For a period of at least three years, the subject institution failed to force place required flood insurance in a timely manner in connection with their portfolio of residential mortgages serviced by the vendor.

This case is a good reminder for institutions to review:

- Vendor policies, procedures, and practices including monitoring for sample populations of notifications sent and force-placed policies.
- Internal policies, procedures, and practices related to force placement and notification, including monitoring sample populations.



- Compliance protocols for monitoring flood insurance requirements and vendor practices, including inquiry into whether the current Compliance Management System protocols would detect a similar condition at your institution.

Another large FI was cited in August of 2023 with violations of the Flood Disaster Protection Act, resulting in civil money penalties in the amount of almost \$3 million. These violations occurred for a period of one year in which system changes resulted in a lack of flood coverage monitoring for the FI's Home Equity Line of Credit (HELOC) portfolio. <sup>7</sup> The takeaway for FIs is clear:

- Ensure that system changes are subject to compliance due diligence prior to implementation.
- Provide compliance consultation during implementation.
- Review the results of system changes after implementation through monitoring to detect any unanticipated impacts of the change.

## The Deep Waters of Private Flood Insurance

In 2019, regulators finalized the then-long-awaited Private Flood Insurance rules. Private Flood insurance can be a preference for those borrowers who want limits higher than what the NFIP offers, or enhanced protection, such as living expenses if the home becomes uninhabitable due to a flood. While the industry has now been working with these requirements for several years, the regulation's mandatory acceptance requirement and discretionary acceptance permissibility have proved to be a complicated area due to its many nuances and the (likely unintended) implications that have come with it.

### ***Mandatory Acceptance—What MUST be accepted?***

Financial institutions are required to accept any flood insurance policy that meets the statutory definition of "Private Flood Insurance" and is issued with an adequate coverage amount. A policy meets this definition if:

- It is issued by a licensed insurance agency or an appropriate surplus lines insurer,

- The coverage is at least as broad as that offered by the NFIP, and
- It contains the required information and technical provisions related to cancellation and filing suit.

The requirement to accept policies meeting this definition is unequivocal, but the difficult part of implementing these provisions has been in determining whether a given policy meets this definition and the level of review necessary to support that determination.

To simplify the review and acceptance of private flood insurance, regulators created the Compliance Aid Statement. The Compliance Aid Statement sets forth the following:

*"This policy meets the definition of private flood insurance contained in 42 U.S.C 4012a(b)(7) and the corresponding regulation."*

Because the absence of the statement cannot be taken as evidence that the policy does not meet the standard, any time the client presents the FI with a privately issued flood insurance policy,<sup>8</sup> the FI must review enough information to determine whether it qualifies for mandatory acceptance. It is possible that the declarations page may be enough to make this determination, but in many cases, FIs will likely need to review the full policy document. The amount of information sufficient to make the determination will vary depending on the presence of the Compliance Aid statement.

- If the Compliance Aid statement is present (and appears verbatim as provided above), an institution may accept that the policy is subject to the mandatory acceptance rule in full reliance on that statement without performing further review. FIs may review the policy further, but are not required to do so.
- If the Compliance Aid statement is not present, an institution must engage in a more comprehensive review of the policy to determine whether it must be accepted pursuant to the mandatory standard.

One final note, FIs may rely on previously completed and documented reviews, provided the terms of the policy have not changed

provided the terms of the policy have not changed.

### ***Discretionary Acceptance—What CAN be accepted?***

Financial institutions are not required to accept any non-NFIP flood insurance policy that does not meet the parameters of the mandatory acceptance requirement. However, acceptance of such a policy may be allowed under the discretionary acceptance standard. Despite the permissive nature of this provision, institutions should still proceed with caution. Policies accepted on a discretionary basis must undergo individual review to determine whether the policy is issued by an acceptable provider, covers both the mortgagee and mortgagor, and provides sufficient protection for the property consistent with general principles of safety and soundness. Further, this analysis must be individually documented as to why the policy in question was found to be sufficient. <sup>9</sup>

However, these provisions governing discretionary acceptance have proved to be a bit of a murky bog for the industry. While it may be fairly simple to determine whether the policy is issued by an appropriate insurer and whether it covers both parties, FIs have struggled with what is sufficient to show the policy's adherence to safety and soundness principles. Thankfully, the updated Interagency Q&A enumerates five principles that FIs may choose to consider in this analysis:

- A policy's deductible is reasonable based on the borrower's financial condition;
- The insurer provides adequate notice of cancellation to the mortgagor and mortgagee to allow for timely force placement of flood insurance, if necessary;
- The terms and conditions of the policy, with respect to payment per occurrence or per loss and aggregate limits, are adequate to protect the regulated lending institution's interest in the collateral;
- The flood insurance policy complies with applicable State insurance laws; and
- The private insurance company has the financial solvency, strength, and ability to satisfy claims. <sup>10</sup>

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policy meets the discretionary acceptance criteria, but FIs are free to develop their own frameworks for this analysis. The key to compliance with the discretionary acceptance provision, however, is to ensure file documentation at the loan/policy level that shows the analysis. Blanket approval for discretionary acceptance of policies from a particular insurer or procedures that allow for a policy to be marked as acceptable without documentation of the analysis will create significant risk of non-compliance. While the regulation and accompanying guidance do not specify the exact type of documentation necessary, it is clear that such documentation must be in writing and specific to the loan, client and policy.

### ***Private Policy Compliance Leaks into Fair Banking***

While our focus has primarily been on what the private flood insurance rules mean for policy acceptance, questions about potential fairness implications have been circulating. As with nearly every client-related decision point, FIs should consider whether criteria are applied consistently and whether the impacts of that criteria are fair to the clients we serve. Recent indications show that examiners may ask FIs for information regarding the privately issued flood policies that they have refused to accept, as they will seek to understand the reasons for rejection. Further, program-specific requirements for Federal Housing Administration (FHA) loans are causing rejection of many privately issued flood policies, which can appear as though there is disproportionate rejection of policies submitted by Low-to-Moderate Income borrowers. Though we have so far focused on the criteria for acceptance, prudent compliance and risk managers will incorporate review of rejected policies and associated data into their programs in anticipation of this new layer of scrutiny.

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## THE IMPORTANCE OF CROSS-COLLATERALIZATION

At its most basic level, we know that the FDPA and its implementing regulations require that adequate coverage be obtained upon closing a designated loan and then maintained throughout the life of that obligation. This deceptively straightforward requirement can become complicated by broad language creating cross-collateralization between loans, especially when that language is used in a boiler-plate manner. Such language takes many forms and is effective to create liens on both real estate and potentially personal property subject to flood insurance requirements regardless of the document in which it is located. Additionally, the Interagency Q&As have now clarified that perfection of a lien is not necessary for flood insurance requirements to be triggered. <sup>11</sup>

The total amount of all outstanding liens against property located in a SFHA is integral to determining whether insurance coverage is adequate. Broad and over-inclusive language in loan documentation has the potential to increase the amount of coverage necessary on such property by increasing the amount of outstanding liens.

For example, Loan A for \$100,000 is secured by a building in a SFHA and the security documents contain language that grants that property as security for future indebtedness to the FI. One year later, the client signs a new unsecured loan for \$25,000. Because of the cross-collateralization language within Loan A, the origination of Loan B increases the total outstanding liens against the property to \$125,000 despite the fact that Loan B is considered unsecured as a product. Accordingly, if Loan B is closed without a review for flood insurance implications, a violation could occur due to inadequate coverage.

Because inclusion of broad language creates additional recourse options for FIs, it is often included as a matter of course in loan documentation as a mitigant to credit risk. Most, if not all, institutions also have a portfolio full of loan documentation produced by different loan origination systems, documents from previously acquired institutions, and attorney-prepared creations. As a result, FIs may not be able to make sound assumptions regarding the presence or absence of this language in any given loan within its portfolio.

How can this unruly and frighteningly common risk be adequately addressed?

The industry has taken notice of examiner focus on this issue, and prudent risk

The industry has taken notice of examiner focus on this issue, and prudent risk management will include proactive review of your FI's current practices regarding usage of cross-collateral language. Cross-collateralization language in loans already within the portfolio can be activated by new loans regardless of current practice, however, so complete control of this risk without other action would likely need to include a complete review of all loan and security documentation on file for a particular client prior to closing any new obligation. Alternatively, many institutions are including collaboration with legal counsel to consider the utility of retroactive release of broad language within their flood portfolio.



## **Storms on the Horizon Beyond Compliance**

An FI's primary risk relative to flooding is not, however, limited to compliance with the FDPA. Climate change-associated events and losses are increasing,<sup>12</sup> and the risks associated with floods and flood insurance are increasingly fluid. As Compliance and Enterprise Risk Management functions continue to intertwine and collaborate within our institutions, Compliance can benefit from understanding the ongoing and increasing risk presented by flooding and climate change.

There are many impacts from these events across the institution. For example, business continuity planning should include an assessment of the impact of

unexpected flood and climate events on branches, operations centers, systems and/or remote employees. The Business Continuity function likely has access to important flood data, trends and forecasts. Consider how our functions may be able to work together utilizing available data to better understand the risks presented by flood and flood insurance across FI functions.

From a credit risk and safety and soundness perspective, the importance of properly insuring our collateral is increasing with rates of flooding and increasing costs associated with flood damage. While the FDPA regulation establishes clear minimum levels of coverage, FIs retain the ability to require more flood insurance than required by law or may be available through the NFIP. Should an institution choose to mitigate risk to collateral by requiring more insurance, clear policies and procedures for determining when the FI may require additional coverage and for calculating the amount of coverage to be required. Discretionary or inconsistent use of this ability could implicate fairness if not implemented clearly and equitably.

The seas of flood compliance are never calm. Regulatory changes, clarifying guidance and complex implementation are the choppy waters on which we live—but robust risk management and proactive understanding of the current climate are sure to help FIs watertight their compliance programs.







## ABA MEMBER RESOURCES

### **ABA Resource: Reference Guide to Flood Compliance**

[aba.com/news-research/analysis-guides/reference-guide-to-flood-compliance](https://aba.com/news-research/analysis-guides/reference-guide-to-flood-compliance)

### **ABA Training: Flood Disaster Protection Act for Compliance Professionals**

[aba.com/training-events/online-training/flood-disaster-protection-act-for-compliance-professionals](https://aba.com/training-events/online-training/flood-disaster-protection-act-for-compliance-professionals)

### **ABA Topic: Flood Insurance**

[aba.com/banking-topics/consumer-banking/insurance/flood-insurance](https://aba.com/banking-topics/consumer-banking/insurance/flood-insurance)

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## ABOUT THE AUTHOR

**KATHRYN MORRIS** is an independent consultant and the founder of Morris Legal & Consulting. With nearly twenty years in banking and compliance, Kathryn's career has spanned a variety of economic and regulatory environments. She is proud to serve on the Advisory Board and Faculty of the ABA Compliance Schools.

As a self-described Compliance Nerd, Kathryn has found great joy in combining her regulatory background with her passion for engaging training and education. She strives to bring her audience precise and actionable knowledge with positive energy and humor whether in writing or as a speaker. In her consulting work, Kathryn lives her professional philosophy that risks and challenges are often opportunities to enhance processes and protect both consumer and business interests.

Kathryn holds a Juris Doctorate from Syracuse University College of Law. When not immersed in professional pursuits, she can be found doing indigent parole defense work, traveling and exploring, and chasing interesting art. The contents of this article do not constitute legal advice. Reach her at [kathryn@morrislegalconsulting.com](mailto:kathryn@morrislegalconsulting.com) and [Linkedin.com/in/kathryn-morris-mlc/](https://www.linkedin.com/in/kathryn-morris-mlc/).

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## ENDNOTES

1. <https://www.fema.gov/flood-insurance>
2. Federal Emergency Management Agency, NFIP's Pricing Approach, <https://www.fema.gov/flood-insurance/risk-rating>.
3. Interagency Flood Insurance Q&As were issued in May, 2022, which provide helpful guidance in understanding the new changes. These Q&As replace those originally published by the agencies in 2009 and 2011, and consolidate Q&As proposed by the agencies in 2020 and 2021. The revised Q&As reflect the significant changes to the flood insurance requirements and cover a broad range of technical topics, including the escrow of flood insurance premiums, the detached structure exemption to the flood insurance purchase requirement, and force placement procedures, in addition to some topics that will be discussed here.
4. Loans in Areas Having Special Flood Hazards, Interagency Questions and Answers, ZONE 1. (Q&A)
5. Q&A, ZONE 3.
6. Office of the Comptroller of the Currency, 2020 Consent Order, <https://www.occ.gov/static/enforcement-actions/ea2020-001.pdf>.
7. Federal Reserve, 2023 Enforcement Action, <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20230822a1.pdf>.
8. Q&A, PRIVATE FLOOD INSURANCE 11.
9. 12 C.F.R. §22.3(c).
10. Q&A, DISCRETIONARY 4.
11. Q&A, COLLATERAL 10.
12. National Centers for Environmental Information, Billion-Dollar Weather and Climate Disasters, <https://www.ncei.noaa.gov/access/billions/>.

# Is Your Grandmother's Sou-Sou Savings Club the Key to Community Wealth Building?

This West African participatory system isn't new but it could be the answer to escaping the discriminatory limits of conventional banking systems.

By [Hannah Nwoko](#)

Updated on January 12, 2024

Fact checked by [Karen Cilli](#)

As a child, you were probably taught the importance of [saving money](#). Safekeeping money given by the tooth fairy and putting birthday money into a piggy bank were common ways to do this but you may also have heard your parents, grandparents, or other relatives talking about the communal saving practice of sou-sou.

A su-su, or sou-sou, is an informal, rotational saving method in which a small group of trusted people contributes a fixed amount (e.g. \$50 or \$100) to a pool of money on a fixed basis (e.g. weekly or monthly). Each month, the pot goes to a different person until everyone in the group has collected. It's essentially a form of mutual aid based on community and shared commitment. There's no interest or profit accrued over time and you get back exactly what you put in—no gain, no loss. The arrangement enables people to save and periodically have access to a lump sum of capital.

The practice is thought to have originated in pre-colonial Nigeria<sup>1</sup> before spreading to other West African countries such as Ghana. It then migrated to the Caribbean through the Transatlantic slave trade and was eventually brought to the US via immigrants. The term su-su comes from the Yoruba word Esusu<sup>2</sup> and it refers to a community fund. Among the Igbo people, it is spelled Isusu. In the Hausa region, it is known as Adashi.

## Community Building and Reciprocity

Dr. Caroline Shenaz Hossein, University of Toronto professor and founder of [The Diverse Solidarity Economies Collective](#), describes sou-sous as

ROSCA. “It stands for Rotating Savings and Credit Associations and it’s the academic term for money pooling co-op banks, known locally as Susu, Hagbad, Padner or Chamas, etc. among African-descended people. ROSCA is a global institution practiced around the world.”

“It is rooted in membership, community building, and this idea of reciprocity,” she explains. “This ancient economic system of collectivity has helped people of African descent to mitigate daily harms, violence, and erasure by creating their own economic solidarity systems and engaged citizenry.” Community-economic practices, such as sou-sous, were historically developed by disenfranchised communities as a response to bias and exclusion from global financial markets as well as the denial of access to commercial banking institutions.

“But know that ROSCAs, or susus, are far more than just a financial transaction, it is about community development, engaged citizenship and building up comradery among excluded people,” Dr. Hossein mentions.

Sou-sous are intrinsically linked with maintaining community life and the encouragement of a people-led economy. They emphasize a strong focus on community well-being without the individualistic and conformist ideologies<sup>3</sup> found in mainstream banking. Importantly, sou-sous contribute to bottom-up development within the community.

## **More Appealing Than a Bank**

There are a few key factors that make sou-sous appealing. The first is accountability—there is an unspoken pressure to continue to add to the pool of money as members don’t want to disappoint the rest of the group by failing to commit. Members are dependent on each other. This can be viewed as a form of positive peer pressure to save and serves as a reminder to follow through on the promises we make to ourselves.

The second factor is the value that comes from pooling resources—sou-sous offer the opportunity to share risk so that if one member has a financial emergency, the rest of the group can mobilize to pay the pot of money out to that person earlier. “Those who receive the funds early in the cycle may be considered to have borrowed money from the group while those who receive funds later are deemed savers; borrowers pay no interest and savers receive no interest income,” Dr. Hossein highlights in her 2023 essay on the West African System of Collectivity.<sup>4</sup>

The third factor is the social desirability of sou-sous—through them, social ties are recognized, social relationships are maintained and they encourage members to think beyond self-interest. The informal system is useful in sharing ideas and building a strong civic society rooted in reciprocity and equal distribution. Naturally, for sou-sous to work effectively, there needs to be a code of conduct, trust, and a collective understanding of the objective of the community.

Sou-sous are largely about building group economic power within Black communities through micro-financing. This is especially important considering access to financial and savings institutions is sometimes limited for Black Americans.

## **A History of Disparities**

[A 2021 survey](#) revealed that Black households ranked high among those without bank accounts, stating reasons such as a lack of trust in banks and not having enough money to meet minimum balance requirements. [Research](#) by the Consumer Federation of America also reported that many Black Americans worry about their financial futures with less than half of Black households having a savings account at a bank or credit union. Many with an account said they were not saving enough for emergency expenditures.

Historically, Black families have also been denied, by law, the opportunity to establish and accrue generational wealth. According to [research](#), the net wealth of a typical Black family in America is around one-tenth that of a white family with data showing that little progress has been made to reduce income and wealth inequalities between Black and white households over the past 70 years.<sup>5</sup> Statistics further reveal that [access to funds for individuals and entrepreneurs is uneven based on race](#).

This disparity can be traced back through the transatlantic slave trade when enslaved people spent hundreds of years creating wealth for their white owners. Following the abolition of slavery and the introduction of Jim Crow laws, there were the broken promises of "40 acres and a mule"<sup>6</sup> that directly impacted thousands of Black families and snowballed into centuries of inequality. Discriminatory lending practices and redlining further contributed to the racial wealth gap and built a lack of trust in banks and government organizations.<sup>7</sup>

“The experience of racial capitalism, violence, and business exclusion is not new for Black people and it’s very much a part of everyday living across the Americas,” emphasizes Dr. Hossein. Instead, susus offer an alternative traditional way to handle finances outside of the control and policing of banks.

“Members in a susu system are able to build wealth, rotate savings among each other. Women and men who use these systems, take the time to save, make personal sacrifices to help one another. So they use the funds they receive in turn as a blessing, to buy inventory for their business, pay school fees, purchase appliances, pay off bills and to attend to life cycle needs,” she explains.

## **A Modern Savings Tool**

Denise Bernard, originally from Grenada, uses her sou-sou, which she calls padner, to send money to her family back home. “Without padner, I wouldn’t be able to save as frequently. It’s easy to forget to put money away every week or every month so the sou-sou forces me to stay on top of my financial goals and stick with it.”

“I get a lump sum and usually I send the money back home to help family. That money makes a world of difference. I know people who send the money back home to build houses or to do home improvements back in Grenada, so the money helps the community out there,” she explains. “Some rounds are bigger with people who want to save more aggressively so they put in \$200 per month. Once it’s over you can start again if you want or you can stop. I’ve done a few rounds,” Denise says.

“My dad introduced us to this method of saving when we were still young. He always said it was integral to survival because he didn’t have faith in the banking system. It helped him acquire things for our family without the excessive bank fees,” she explains. She mentions that her adult son is also part of a sou-sou and he is putting the money towards a downpayment for a property for himself and his long-term girlfriend.

Despite sou-sous being an informal approach, they can be formalized to help aid members with issues such as credit. In Harlem, Reverend Dr. Charles Butler, VP of Equitable Development at [Harlem Congregations for Community Improvement](#), started facilitating sou-sous in 2016 and uses them to report to credit bureaus. This has allowed members of the group to not only save but also increase their credit scores.

Having a good line of credit is essential when it comes to applying for mortgages, other loans, and credit cards, so Reverend Butler's sou-sous have been a lifeline in regularizing the saving process while giving members tangible benefits that contribute to their financial liberation.

For Black people, it's sometimes difficult to build wealth without community ownership and collective thinking.<sup>4</sup> When working to reach a financial goal or improve financial habits, doing it from a communal perspective can have a positive impact. Looking at sou-sou savings clubs, traditionally run informally by aunties and grandmas, as an example of building an endowment fund and pursuing economic mobility could be the key.



# BSA/AML Traps for the Unwary: FinTech Compliance Does Not Always Equal Bank Compliance

**Phelps Dunbar LLP**



**USA** | February 2 2024

The new year is a good time to revisit policies and procedures and ensure they reflect the goals and risks of your institution. With rapidly evolving technology, frequent and regular review of policies and procedures is important to mitigate loss and ensure safety and soundness. For banks working with Financial Technology (FinTech) providers – whether as partners to extend their reach or as internal resources to support existing operations – few areas of risk need more frequent attention than **Bank Secrecy Act/Anti-Money Laundering (BSA/AML)** compliance.

BSA/AML risk and compliance routinely ranks among the top examination priorities for federal functional regulators and results in enforcement actions and millions of dollars in fines and penalties every year. While banks and FinTechs often have independent compliance obligations, banks cannot delegate their compliance burdens to their FinTech partners. And a FinTech's satisfying of its independent obligation does not satisfy the bank's obligation. For while the compliance obligation for banks and FinTechs are in many cases similar, a bank must comply with its obligations, not those of its FinTech partner.

The difference between the bank's obligations and those of its FinTech partner often leads to differences over what it means to comply with or satisfy BSA/AML requirements. Fundamentally, though, when structuring FinTech arrangements, because FinTechs work with banks as a service provider, the obligation should be for the FinTech to meet the bank's, not for the bank to accept the FinTech's.

**What's the difference between BSA/AML compliance for FinTechs and banks?**



FinTechs are often categorized as money services businesses for BSA/AML purposes. Federal regulations require money services businesses to obtain and retain certain limited transaction-level information, such as the name and address of the funds transmitter, the date and amount of funds transmitted, and the name and address of the recipient.

While transactions with certain individuals or transmission of funds to certain jurisdictions are prohibited, FinTechs generally have no independent obligation under federal law to ascertain the source of funds or to "know" the transmitter to the extent banks are. FinTech responsibilities are generally documentary, meaning they must screen for certain transactions, keep records and report various transactions to law enforcement authorities.

By contrast, banks are required to adopt and implement a robust BSA/AML program that includes "at a minimum":

- Internal controls that assure compliance
- Independent compliance testing
- A designated BSA officer responsible for coordinating and monitoring compliance
- Formal training and testing for personnel
- Robust customer due diligence

Banks' customer due diligence must determine the nature and purpose of the customer relationship, build customer risk profiles, and identify and mitigate risk. For each customer, this involves documenting sources of funding, typical transaction volumes, types and ranges, typical payees, etc.

Customer identification programs for banks are also heavily proscribed by federal regulation and require documentary and non-documentary identity verification through specified methods. For non-individual customers, banks must drill down to determine and identify individual owners. This gives banks a full view of each transaction to help them identify suspicious transactions and coordinate with law enforcement authorities to prevent intermediating or funding illegal activities.

### **How do bank/FinTech agreements assign compliance duties?**

In many bank/FinTech partnerships, the FinTech undertakes principal compliance activities for the program it runs with, through, and on behalf of the bank. This activity is memorialized in the program agreement and is often captured in somewhat general language. For example, it is not uncommon for program agreements to

provide language to the effect that:

Program Manager and Bank shall develop, and Program Manager shall implement, policies and procedures to comply with all know-your-customer (KYC), anti-money laundering (AML), and identity verification (IDV) rules and regulations applicable to the Customer Accounts under Applicable Law and Bank Rules. Program Manager shall make commercially reasonable efforts to ensure compliance with all Applicable Law and Bank Rules pertaining to KYC, AML and IDV in connection with each Program and maintain appropriate record-keeping relating to the foregoing. Such policies and procedures, which shall be in effect prior to enrolling any Customers in a Customer Account, are subject to prior review and written approval by Bank, which approval shall not be unreasonably conditioned, withheld or delayed.

And while program agreements often allow the bank to review the FinTech's policies and procedures regarding BSA/AML compliance, as well as monitor and audit the program for compliance, it is not uncommon for banks to rely on the FinTech more heavily than is perhaps wise. The general nature of standard program agreements and the over-reliance by the bank create an opportunity for misunderstanding, on the one hand, and non-compliance, on the other, since the fundamental nature of "compliance" for a FinTech is in many cases different than for a bank. Left to its own devices, in good faith, a FinTech partner may satisfy its regulatory obligation without satisfying the bank's. This creates regulatory and perhaps civil or criminal exposure for the bank, not to mention the opportunity for customer harm and reputational risk.

### **How can banks ensure compliance?**

To ensure BSA/AML compliance, banks need to understand their regulatory obligations and set policy based on those obligations and their strategic goals. From there, they should develop procedures to support the policy. For banks working with FinTechs, particularly those on whom the bank is relying to meet its compliance obligations, procedures must include activities designed to understand the FinTech's own policies and procedures, to monitor and test compliance with those procedures, and to evaluate the results.

As discussed above, the critical lens through which "compliance" must be viewed is that of the bank and its obligations, rather than those of the FinTech. Banks must also ensure the program agreement obligates the FinTech to modify its policies, procedures, training and implementation of BSA/AML compliance-related activity if the bank's monitoring and testing reveal deficiencies. To avoid misunderstandings and disputes, this right should be specifically set out in the program agreement instead of just tacitly understood.

'Tis the season to review policies and procedures! With respect to FinTechs and BSA compliance, that means the bank's policies and procedures, and those of their program partners. Banks reviewing their positions should make sure obligations and expectations are aligned in their FinTech program agreement.

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