EM-33.1

Category: **Compliance**
Topic: **Federal Lending Regulations**
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Overview

The descriptions and guidance below should not be interpreted as comprehensive statements of the regulations. Rather, they are intended to give a broad overview of each regulation's requirements and provide examiners with key considerations for examining compliance at Farm Credit System institutions.

This section contains FCA's standard procedures for examining compliance with federal lending regulations; however, the guidance for several of the procedures is currently under development. In the interim, the following links provide related guidance that was contained in the old FCA Examination Manual:

- EM- 605 Introduction
- EM- 650 Flood Insurance

Examination Procedures and Guidance

General

1. HMDA:

Evaluate the adequacy of guidance and controls to ensure compliance with the Home Mortgage Disclosure Act (HMDA) (Regulation C).

Guidance:

The Home Mortgage Disclosure Act (HMDA) is implemented by the Consumer Financial Protection Bureau (CFPB) Regulation C, Home Mortgage Disclosure, Title 12 CFR Part 1003. Regulation C's purpose is to provide the public with loan data that can:

- Help determine whether financial institutions are serving the housing needs of their communities.
- Assist public officials in distributing public-sector investments to attract private investment to areas where it is needed.
- Assist in identifying possible discriminatory lending patterns and enforcing compliance with anti-discrimination statutes.

Institutions covered by the regulation must report, in a HMDA Loan/Application Register (HMDA-LAR), specified information about their originations and purchases of mortgage loans (home purchase and refinancing) and home improvement loans. This includes loan applications that do not result in originations. Four broad categories of information to be reported per 12 CFR 1003.4

include:

- Information about applicants, borrowers, and the underwriting process, such as sex, ethnicity, age, credit score, debt-to-income ratio, and automated underwriting system results.
- Information about the property securing the loan, such as construction method, property value, and additional information about manufactured and multifamily housing.
- Information about the features of the loan, such as pricing information, loan term, interest rate, introductory rate period, non-amortizing features, and the type of loan.
- Certain unique identifiers, such as a universal loan identifier, property address, loan originator identifier, and a legal entity identifier for the financial institution.

Each covered institution must report this data as specified on the CFPB's HMDA page. Data for each covered institution, as well as aggregated data for all covered institutions in a metropolitan area, will be available to the public on the CFPB's HMDA page per 12 CFR 1003.5.

Evaluative questions and items to consider when examining guidance and controls to ensure compliance with Regulation C include:

- ***Institutional Coverage:*** **Is the institution covered by the requirements of Regulation C?** A System institution is a covered institution if it meets both of the following per 12 CFR 1003.2(g)(2):

    - On the preceding December 31, it had a home or branch office in a Metropolitan Statistical Area (MSA). As addressed in 12 CFR 1003.2(c)(2), an institution is deemed to have a branch office in an MSA or a Metropolitan Division (MD) if, in the preceding year, it received applications for, originated, or purchased five or more covered loans related to property located in that MSA or MD (even if it does not have an office in the MSA or MD); and

    - It originated at least 25 covered closed-end mortgage loans or at least 500 covered open-end lines of credit in each of the two preceding calendar years. An institution is not required to report a closed-end mortgage loan or an open-end line of credit, respectively, unless the institution meets the threshold for that loan type for 2 consecutive years. (The open-end threshold will be 500 loans until December 31, 2019. Absent any further action by the CFPB, the threshold will decrease to 100 open-end lines of credit effective January 1, 2020.)

- ***Transactional Coverage:*** **Has the institution properly defined the types of transactions covered per 12 CFR 1003.2(e) and 1003.3(c)?**

    - Covered transactions generally include applications for and originations of the following loans that are secured by a dwelling:

        - Consumer-purpose (personal, family, or household purposes) closed-end loans and open-end lines of credit.
        - Business-purpose closed-end loans and open-end lines of credit, if the loans or lines of credit are home purchase loans, home improvement loans, or refinancings.

    - Regulation C excludes from its coverage closed-end mortgage loans and open-end lines of credit used primarily for agricultural purposes, even if the loan is secured by a dwelling. A loan or line of credit is used primarily for agricultural purposes if:

  - The loan funds will be used primarily for agricultural purposes; or
  - The loan or line of credit is secured by a dwelling that is located on real property primarily used for agricultural purposes (e.g., a farm).

- Regulation C refers users to Regulation Z for guidance on what is an agricultural purpose. Regulation Z explains that an agricultural purpose transaction includes a transaction involving real estate that includes a dwelling (e.g., the purchase of a farm with a homestead) if the transaction is primarily for agricultural purposes. It allows institutions to use any reasonable standard to determine the primary use of the property and to select the standard to apply case-by-case.

- If a home purchase, home improvement, or refinancing loan or line of credit is secured by a dwelling and is not for an agricultural purpose, it is subject to Regulation C, whether it is a loan made to a farmer, rancher, or aquatic producer or harvester under FCA Regulation 613.3000 or a loan made to a rural homeowner under FCA Regulation 613.3030.

- Covered transactions include preapproval requests for home purchase loans that were approved but not accepted. Pre-approval requests for open-end lines of credit, reverse mortgages, and home purchase loans to be secured by multifamily dwellings are excluded.

- ***Policies and Procedures:*** **Are policies and procedures sufficient to ensure regulatory compliance?** Institutions should have policies and procedures that address and ensure compliance with Regulation C requirements. Effective policies and procedures should include guidance for determining institutional and transactional coverage, compiling reportable data points, and ensuring compliance with disclosure and reporting requirements.

- ***Internal Controls:*** **Are internal controls sufficient to ensure compliance with the regulation and timely detection of violations?** Examiners should determine if internal control processes and audit programs cover the pertinent regulatory requirements associated with Regulation C. Specific individuals should be assigned responsibility for collecting and reporting data and be given sufficient resources to do so accurately. Data tracking systems need to collect and monitor related loan and application data to determine applicability and ensure compliance with Regulation C requirements. Institutions should make a good faith effort to accurately gather and record data. However, an error in compiling or recording data is not a HMDA or Regulation C violation if it was unintentional and occurred despite the maintenance of procedures reasonably adopted to avoid such errors. Audits should include a reasonable amount of transactional analysis to verify data accuracy and compliance with reporting requirements. To determine whether internal controls are adequate to ensure compliance, examiners should review the following for adequacy and effectiveness:

  - Policies and procedures
  - Process flowcharts and checklists
  - Loan file documentation (verification to the HMDA-LAR)
  - Public posting and disclosures
  - Training materials

- ***Reporting:* Has the institution submitted its HMDA-LAR in accordance with 12 CFR 1003.5 and the instructions on the CFPB's HMDA website?** The institution must submit the HMDA-LAR in electronic format by March 1 following the calendar year for which data is compiled. The institution also must retain a copy for its records for at least 3 years.

- ***Posted Notices:* Does the institution provide public notice as required by 12 CFR 1003.5?** An institution must post a general notice in the lobby of its home office and each branch physically located in an MSA or MD that its HMDA data is available on the CFPB's HMDA website at www.consumerfinance.gov/hmda. An institution must be prepared to make disclosure statements available for 5 years and HMDA-LARs (as modified by the CFPB to protect privacy) available for 3 years. The unmodified HMDA-LARs must be retained for at least 3 years for examination purposes.

Examiners should refer to the HMDA section in the CFPB Supervision and Examination Manual for more detailed information and guidance on examining compliance with Regulation C. Additional information can be found on the CFPB's website at HMDA Rule Implementation and Resources for HMDA Filers. The FFIEC also provides helpful information on its HMDA web page.

Note: This examination guidance applies to the version of Regulation C that became effective January 1, 2018, including the Regulation C revisions related to institutional coverage, transactional coverage, and data collection, recording, reporting, and disclosure that were published on October 28, 2015 and additional revisions that were published September 13, 2017. The 2015 revisions were briefly summarized in FCA's Informational Memorandum on Amendments to Regulation C and Regulation Z and Annual Threshold Adjustments under Regulation Z and Regulation M dated January 13, 2016, and the 2017 revisions were briefly summarized in FCA's Informational Memorandum on CFPB Actions on Home Mortgage Disclosure Act, Mortgage Servicing Rules, and TILA-RESPA dated October 23, 2017.

2. TILA:

Evaluate the adequacy of guidance and controls to ensure compliance with the Truth in Lending Act (TILA) (Regulation Z).

Guidance:

3. ECOA:

Evaluate the adequacy of guidance and controls to ensure compliance with the Equal Credit Opportunity Act (ECOA) (Regulation B).

Guidance:

4. RESPA:

Evaluate the adequacy of guidance and controls to ensure compliance with the Real Estate Settlement Procedures Act (RESPA) (Regulation X).

Guidance:

5. Fair Credit Reporting:

Evaluate the adequacy of guidance and controls to ensure compliance with the Fair Credit Reporting Act (FCRA), including the applicable requirements of the Fair and Accurate Credit Transactions Act (FACTA) amendment.

Guidance:

6. Flood Insurance:

Evaluate the adequacy of guidance and controls to ensure compliance with flood insurance requirements (Regulation H and FCA Regulations Part 614, Subpart S).

Guidance:

7. Fair Housing:

Evaluate the adequacy of guidance and controls to ensure compliance with the Fair Housing Act.

Guidance:

8. SAFE Act:

Evaluate the adequacy of guidance and controls to ensure compliance with the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) (Regulation G).

Guidance:

9. Margin Stock:

Evaluate the adequacy of guidance and controls to ensure compliance with Regulation U.

Guidance:

The Federal Reserve Board (FRB) issued Regulation U pursuant to the Securities Exchange Act of 1934. Regulation U sets out certain requirements for lenders who extend credit secured directly or indirectly by margin stock. Margin stock includes any equity security registered on a national securities exchange, such as the New York Stock Exchange or the American Stock Exchange; any over-the-counter security trading in the NASDAQ Stock Market's National Market; any debt security convertible into a margin stock; and most mutual funds. Debt securities convertible into a margin stock would include publicly traded options, such as puts, calls, and combinations.

Evaluative questions and items to consider when examining guidance and controls to ensure compliance with Regulation U include:

- ***Policies, Procedures, and Controls:* Are policies, procedures, and controls sufficient to ensure compliance?** Institutions should have policies, procedures, and controls that address and ensure compliance with the registration, reporting, and lending requirements of Regulation U.

- ***Registration:* Is the institution required to register with the FRB? If so, did it register within the required time frame?** Institutions that extend credit secured directly or indirectly by margin stock and that meet the following requirements must register with the FRB using Form FR G-1. This one-time registration must be completed within 30 days after a quarter-end where either of the following has occurred:

    - Credit extended during the quarter secured by margin stock was $200,000 or more.

    - Credit outstanding at any time during the quarter secured by margin stock was $500,000 or more.

- ***Margin Requirements:* Did the institution comply with the margin requirements (currently 50 percent) for *purpose credit* secured directly or indirectly by margin stock?** Purpose credit is any credit for the purpose, whether immediate, incidental, or ultimate, of buying or carrying margin stock. Institutions must not extend any purpose credit, secured directly or indirectly by margin stock, in an amount that exceeds 50 percent of the margin stock's current market value.

- ***Reporting:* Is the institution appropriately completing and filing the required FRB forms?**

    - FRB Form FR G-1 – Registration Statement for Persons Who Extend Credit Secured by Margin Stock (Other Than Banks, Brokers, or Dealers): Institutions must file this form as discussed above under *Registration*.

    - FRB Form FR G-2 – Deregistration Statement for Persons Registered Pursuant to Regulation U: Institutions may use this form to deregister with the FRB if, during the preceding 6 calendar months, it has not had more than $200,000 of credit secured by margin stock outstanding. Deregistering is optional, but institutions that do not deregister must file an annual report (FRB Form FR G-4) every year.

    - FRB Form FR G-3 – Statement of Purpose for an Extension of Credit Secured by Margin Stock by a Person Subject to Registration under Regulation U: The borrower and lender must complete this form for each extension of credit secured directly or indirectly by margin stock. It must be kept in the lender's records for at least 3 years after the termination of the credit.

    - FRB Form FR G-4 – Annual Report: Institutions (unless they have deregistered) must use this form to file an annual report with the FRB within 30 days of June 30. The report shows their lending activities secured by margin stock, including the amount of such credit outstanding and extended during the year.

For detailed information and forms, see the FRB's Regulation U Compliance Guide.

10. Consumer Leasing:

Evaluate the adequacy of guidance and controls to ensure compliance with Regulation M.

Guidance:

11. OFAC Requirements:

Determine compliance with the Office of Foreign Asset Control (OFAC) requirements related to monitoring for Specially Designated Nationals.

Guidance:

12. SCRA & MLA:

Evaluate the adequacy of guidance and controls to ensure compliance with the Servicemembers Civil Relief Act (SCRA) and Military Lending Act (MLA).

Guidance:

13. Audit:

Determine if the institution conducts an effective audit (scope, reporting, and followup) of compliance with federal lending regulations.

Guidance:

The internal audit and review program is a key mechanism for ensuring compliance with federal lending regulations and policies. The internal auditor (or other qualified, independent party) should review the adequacy of lending practices to ensure compliance with applicable criteria. The audit risk assessment and scope should address federal lending regulations, and audit frequency should be commensurate with the complexity of the institution's operations and risk profile. The scope should include a review of policies and procedures as well as a transaction review. A reliable audit program provides the board reasonable assurance that processes are effective.

Evaluative questions and items to consider when examining the audit function regarding compliance with federal lending regulations include:

- ***Audit Coverage:*** **Is there periodic audit or review coverage of all applicable federal lending regulations?** Audit or review coverage and frequency should be appropriate relative to risks, changes in the operating environment, regulatory requirements, and periodic testing needs. Coverage should also be consistent with the institution's risk assessment results and annual audit plan.

- ***Scope and Depth:*** **Are audit or review scope and depth sufficient to conclude on the adequacy, completeness, and timeliness of lending processes?** The scope should cover key processes and controls within the area being audited or reviewed. The depth of work should be sufficient to determine if internal controls are functioning as intended and regulatory requirements are met. The scope and depth of coverage should be consistent with the approved audit or review plan and engagement contract (if applicable). If audit or review work deviated materially from the original planned scope, the board (or Audit Committee, if so delegated) should be notified of the reasons for the change. Specific items that should be considered in the audit or review scope include:

- Lending processes and controls. Internal audits or reviews should address all federal lending requirements that are applicable and relevant to the institution.
- Policies, procedures, templates, and other guidance related to federal lending regulations.
- Compliance with federal lending-related regulations, policies, and procedures. Audits or reviews should include sufficient transaction testing to detect noncompliance with established criteria.
- Fraud-related threats and vulnerabilities, as well as anti-fraud controls.

- ***Reliability of Results:*** **Did FCA identify any concerns with audit and review reliability?** Evaluate the reliability of internal audit or review work by comparing the results to FCA's examination results in this area. This comparison often includes FCA testing of transactions that were covered in the internal audit or review (transactions are often loans or loan applications, but may include other types of transactional activity, as well). In addition to the audit or review report, examiners should request and review the workpapers and hold discussions with the auditor to obtain a more thorough understanding of work completed. Often, auditors and reviewers will complete line sheets, flowcharts, control matrices, standard work programs, workpaper forms, or other relevant documents when conducting work. Workpapers should adequately document the work performed and support the final report. In addition, any proforma work programs, workpapers, or other tools should be accurate and sufficiently thorough. If there are material weaknesses identified by examiners that are not identified by internal audits or reviews, examiners should assess the underlying reasons.

- ***Reports:*** **Do internal audit reports sufficiently communicate review results and recommendations, if applicable?** Examiners should consider the following when evaluating the audit or review report:
  - Is the report prepared in accordance with the institution's guidelines?
  - Is an executive summary or overview included to provide the board with a general conclusion on audit or review results?
  - Is the report accurate, concise, supported, and timely in communicating the audit or review objectives, scope, results, conclusions, and recommendations?
  - Are conclusions and recommendations realistic and reasonable, with material and higher risk issues clearly identified and prioritized?
  - Are conclusions and recommendations supported by convincing evidence and persuasive arguments (condition, criteria, cause, and effect)?
  - Does the report conclude whether the institution adheres to policies, procedures,

and applicable laws or regulations, and whether operating processes and internal controls are effective?

  - Does the report address potential vulnerabilities to fraud, if applicable?

- ***Corrective Action:*** **Are management responses to audit findings in this area reasonable, complete, and timely? Have corrective actions been effective?** Audits and reviews are only effective if corrective action is taken to remedy the weaknesses identified. As such, there should be a reasonable, complete, and timely management response to the audit or review report. In some cases, management commitments and agreements or any areas of disagreement are documented in the report or in a separate memo or tracking system. If corrective actions are not resolving the issues or concerns (based on repetitive audit findings, FCA findings, etc.), examiners should further investigate the reasons. For example, this could indicate the audit or review did not sufficiently identify the underlying causes or materiality of weaknesses, sufficient resources are not being directed toward corrective actions, or weaknesses exist in the institution's corrective action process, including board oversight of the process.

14. Transaction Testing:

Examine individual loans and applications to assess compliance with federal lending regulations and the effectiveness of institution control processes.

Guidance: