



Compliance News...

Actual/360 Accrual Method On Loans

Banker's Compliance Consulting has received several questions regarding the use of the actual/360 accrual method on loans. Recently, Wolters Kluwer (formerly Banker's Systems) released a statement with their last lending software update stating, "*Lenders that choose the actual/360 accrual method assume any liability resulting from the use of this method*". The statement also indicated institutions should be aware that this method of accruing interest could be viewed as deceptive and may result in an Unfair & Deceptive Trade Practice violation.

Regulation Z (Truth in Lending) does not require the use of a specific interest accrual method; however, the Annual Percentage Rate (APR) must be accurately disclosed using the actual/365 accrual method ([Appendix J](#) of Regulation Z). An APR disclosure violation may occur when a financial institution applies a daily periodic rate based on a 360-day year to the actual number of days between payments. If the APR disclosure is out of tolerance (Section [226.22\(a\)](#)), the financial institution is in violation of Regulation. Z. This is most likely to occur on short term, single payment loans.

The Federal Reserve Bank has provided additional guidance on this issue in its [Consumer Compliance Handbook](#) (bottom of page 17 of this link). Banker's Compliance Consulting recommends financial institutions review which method they are using on consumer loans, any applicable state laws and contacting legal counsel for additional guidance, if applicable.

OCC Issues Expectations For Bank Issued Gift Cards

The Office of the Comptroller (OCC) issued [bulletin 2006-34](#) on August 14, 2006. This guidance addresses gift cards sold by a financial institution with the Visa, MasterCard or American Express logo to a consumer that may potentially pass the card on as a gift. The bulletin describes disclosures to the purchaser, recipient and practices to avoid. While not required by regulation or law this is clearly something the OCC expects to see from financial institutions providing the gift cards.

Banker's Compliance Consulting Q & A Forum...

The following Q & A's were generated by a recent "Applicants, Applications and More" Webinar presented by Banker's Online and taught by David Dickinson, President of Banker's Compliance Consulting. The following website has complete information regarding past and future Bankers Online webinars:

<http://www.bollearningconnect.com>.

Prequalification

Question 1. When does a pre-qualification turn into an application?

Answer: A pre-qualification becomes an application when the creditor has enough information to make a credit decision according to the creditor's established procedures.

Question 2. We have a prequalification worksheet that collects basic applicant information. We use a credit bureau report to determine how much they could qualify for and convey that information to the applicant(s). Is this an application and is it acceptable to pull a credit report? If we tell them we cannot pre-qualify them, is an adverse action notice required?

Answer: The pre-qualification is an application for credit and you can pull a credit bureau report as you have a legitimate business need. If you determine the applicant would not qualify for credit based on the credit report, you would need to send an adverse action notice.

Question 3. If we tell a consumer how much they are pre-qualified for does this trigger application requirements? Could we tell them, this is what they are pre-qualified for and the next step is to apply?

Answer: This is a pre-qualification application approval because you have determined the applicant has qualified for X number of dollars. You have triggered no additional disclosures at this time. If the applicant never finds a house, or goes to another creditor, you have a withdrawal. Pre-qualifications that turn into a "no" by the creditor would be a denial and would constitute an adverse action notice be sent.

Question 4. If a borrower is applying for a home loan but they don't yet have a property, this is a pre-qualification. Does that trigger Real Estate Settlement Procedure Act (RESPA) or Regulation Z? We treat this as an application and give disclosures within the 3 days; however, many of our competitors do not. I often wonder how they get away with not disclosing.

Answer: The definition under RESPA states that you do not have an application until a property has been identified. Regulation Z (Truth In Lending) defers to the RESPA definition. Disclosures do not HAVE to be given until a property is selected. This is more of a customer service, competition or management issue.

Question 5. When the pre-qualification converts to an application, is that the trigger date for RESPA/TIL disclosures? Is it better to complete a whole new application so all the dates match?

Answer: No, do not complete a whole new application. When you have a pre-qualification, you trigger certain regulations, such as HMDA (Regulation C) and Equal Credit Opportunity Act (Regulation B). Document the pre-qualification date. When a property is subsequently identified, you now trigger the disclosures under RESPA and Regulation Z. You have a two phase application in this case.

Denials

Question 6. In response to a consumer's inquiry, the lender requests certain information from the consumer, pulls a credit bureau report and evaluates their credit for the express purpose of determining how to price a potential loan (loans are driven primarily by FICO score). The lender decides that based on the consumer's FICO score the consumer does not qualify for any of the mortgage loan products the bank has to offer and communicates that decision to the consumer. Is this considered an application that requires an adverse action notice according to Regulation B?

Question 7. If we have a borrower without a property and they provide application information to us, but the file does not proceed to underwriting – is this considered a pre - qualification or an application since we are making a preliminary credit decision based on the information provided to us from the borrower?

Answer: Once you have enough information to make a credit decision, you have an application. If that decision is to decline credit to the applicant, you must send the adverse action notice required under Regulation B.

Question 8. A customer calls in with general questions. It becomes an application because you are 'forced' to make a decision. If it is a denial, how do you send an adverse notice if you don't have the 'applicant's' name and address?

Answer: The Commentary to Section 202.9(a)#7 indicates: *“Denial of a telephone application. When an application is made by telephone and adverse action is taken, the creditor must request the applicant’s name and address in order to provide written notification under this section. **If the applicant declines to provide that information, then the creditor has no further notification responsibility.**”* I believe this section provides a “common sense” exemption from sending an Adverse Action Notice when you don’t have the applicant’s name and/or address.

Question 9. We only take basic information on a prequalification worksheet and do not complete the information on a 1003 residential real estate application. We tell the borrower that we cannot pre-qualify or help them; do we have to give an adverse action notice to the borrower?

Answer: Yes, if you have enough information to make a credit decision and can communicate a denial, you have an application. In this case, you need to send the adverse action notice.

Question 10. My understanding of Regulation B is that a creditor cannot use 'credit score' as the reason for taking adverse action. Is this true?

Answer: You cannot tell an applicant that they have been denied because of their credit score, you must give specific reasons. When you deny them you have made a credit decision, thus you have had an application, and you must send an adverse action notice.

Question 11. The commentary to 202.2(f) states: *“A creditor has the latitude under the regulation to establish its own application process and to decide the type and amount of information it will require from credit applicants”.*

Does it give a creditor the flexibility to say that if a loan package submitted by a broker doesn’t include all the information we require, we will contact the broker and ask for it and tell them that if they don’t provide the requested information by a certain date we won’t consider it an application at all and won’t act on it? The missing information that would cause this treatment would be the type that is requested on a 1003 and a typical broker submission form such as: social security numbers on all borrowers, marital status, subject property address, estimated subject property value, loan amount, product and/or term requested, new or current mortgage information, current employer name and borrower income.

Answer: Even if you have established procedures that you will follow to make a credit decision, the Commentary to §202.2(f) of Regulation B states *“the creditor must act with reasonable diligence to collect information needed to complete the application. For example, the creditor should request information from third parties, such as a credit report, promptly after receiving the application. If additional information is needed from the applicant, such as an address or a telephone number to verify employment, the creditor should contact the applicant promptly.”*

If you cannot get the needed information from the broker, you should contact the applicant and try to secure the needed information. If you are unable to get the information you need, you have an incomplete application and should send out an adverse action notice stating the request was denied for incompleteness or send out a notice of incomplete application under §202.9(c). You cannot disregard the information you do have and not call it an application.

Withdrawal

Question 12. If you encourage an applicant to apply, you mail a form and then it is never returned what should be done?

Answer: By regulation you have no requirements. However, I assume you want to make as many loans as possible. Therefore, I would contact the applicant and find out why they did not return the application. It could be they went to a competitor, decided not to make the purchase, etc. If the customer states they have decided not to apply, document the applicant’s answer of withdrawal and you are done. If they are still pending, document this, but you trigger nothing at this point.

Question 13. If a lender pulls a credit report and the applicant never returns is an adverse notice required?

Answer: The question is “why hasn’t the applicant returned?” If you have pulled a credit bureau report, you have evidence they have been in your institution. It is best to contact the applicant, find out why they didn’t return and document the reasons why they haven’t proceeded. You may need to send a notice of incompleteness. If they are withdrawing, then nothing further needs to be done.

Question 14. I have pre-qualified customers and given them an estimated purchase price. Sometimes they find a house, but they never come back. What am I required to do and how long do I have to do it?

Answer: By regulation you have no requirements. However, from a customer service standpoint you should contact the applicant and find out why they have not been back to your institution. If they have withdrawn their application, document their answer and close the file.

Pulling Credit Reports

Question 15. Can you pull credit in conjunction with a pre-qualification and use that as a determining factor in whether someone can be pre-qualified?

Answer: Yes, you can pull a credit bureau report whenever you have a “legitimate business need initiated by the consumer”. However, if that decision is that you will not extend an offer of credit, then you must comply with the adverse action notice requirements and send the Notice of Action Taken within 30 days of your decision. You will need to include the Fair Credit Reporting Act notice that a credit bureau report was used in your decision.

Question 16. When are you required to obtain written authorization to pull a credit report?

Answer: Never by law. You must have a “legitimate business need” to pull a credit bureau report. A lot of banks like to document the authorization of the applicant(s), but it is not a federal regulatory requirement.

Question 17. Does pulling a credit report in itself constitute an application?

Answer: If you can gain enough information from the credit bureau report to make your credit decision, then you would have an application.

Question 18. Does Fair Credit Reporting Act (FCRA) define an application and applicant? Compared to Regulation B, how is it significantly different?

Answer: The FCRA does not define application and applicant

Co-signer

Question 19. For a mortgage loan application, aren't all owners either a borrower or a co-borrower if they are on the title? When would they be a cosigner?

Answer: Your statement “an owner is either a borrower or co-borrower if on the title” is not true. A borrower is someone who is primarily liable for the debt. If I'm on the title of a house, I'm not necessarily a borrower if the house is used as collateral. I could simply release my interest in the collateral (3rd party release). You may request non-applicants listed on the title to sign security documents, but you cannot require them to become liable. A co-signer is someone who assumes liability for a consumer loan and does not receive legal benefit from the loan proceeds.

Question 20. Does an application that says 'joint applicant' cover the issues of co-borrowers and/or co-signers?

Answer: If the person who assumes liability for the obligation of a consumer does not receive any benefit from the proceeds of the loan, they are a co-signer whether you designate them as such on the application or credit obligation. You cannot manipulate this by labeling them “joint applicants”

Miscellaneous

Question 21. I purchase a home and then refinance that loan (that is a refinance). Years later I refinance the refinanced transaction. Can the refinance of a residential real estate purchase only happen once?

Answer: You can have multiple refinances on the same property. A loan is considered a refinance until the original amount is paid down to zero.

Question 22. If a home is “free and clear”, then a new first lien mortgage is taken out (cash out) what is this considered?

Answer: This is a home equity loan. It could also be a home improvement if the proceeds are used to improve the home or property.

Question 23. How do you know if the refinancing of a current residential real estate transaction refinance was on original purchase money, especially if the loan is at a different financial institution?

Answer: In 2004 the Federal Reserve changed the definition of “refinance” in HMDA because of the confusion that you are referencing. HMDA indicates a “refinance” is any loan that satisfies and replaces a loan where both the old and new loans are secured by a dwelling (regardless of purpose). For non-HMDA institutions: If the applicant has never owned the home “free and clear” then it you are refinancing purchase money.

Question 24. Does Regulation X or Regulation Z require that the initial application be signed?

Answer: No, they do not.

Question 25. Is Texas included in these Regulations?

Answer: We are discussing federal regulations today. Texas does have some state laws that are tougher than the federal regulations. Texas may be required do more things, but they would not be exempt from any of these regulations.

Question 26. Pre-qualification vs. pre-approvals for Mortgage Brokers: It is my understanding that brokers cannot approve or deny an applicant; therefore, they cannot issue pre-approvals. Is this understanding correct? What is the alternative/rule for the broker?

Answer: It sounds like that is an agreement between your institution and the broker. This is more of a legal versus compliance issue. If the broker makes the credit decision, the broker is the creditor. Someone has to be responsible for the adverse action notice, so this would be a procedural question for your institution.

Question 27. If a loan goes into default, can the guarantor be reported to the credit bureau as well as the applicant(s)?

Answer: Yes, we believe you can, if the loan is in default and you have exhausted all payment remedies from the borrower and have begun collection activity against a guarantor who is refusing to pay.

Question 28. In relation to Regulation B, how are registered Domestic Partners treated? In California, they have all the rights, title and ownership as if married.

Answer: You should check your state laws on Domestic Partner laws. Under federal Regulation B, you can not obligate a spouse or anyone else on a credit obligation; however, you can request they sign the security instruments. I'm unable to respond to state laws during this webinar.

Question 29. In the handouts, it states a 'Preliminary Truth In Lending Disclosure' is required within 3 days of application. Since Regulation Z does not define an 'application', do we use the definition of an application per RESPA?

Answer: Yes, even though it is not well written, Regulation Z defers to the definition of RESPA for an application regarding a residential real estate transaction. It is understood that even though Reg Z does not define “application” for other types of consumer credit, you would refer to the same definition.

Question 30. When title is held in a trust and the trustees are required to sign individually and as trustees for the trust, what are the trustees considered?

Answer: First, I'm not sure you can "require" trustees to sign individually. Section 202.7(d)(1) prohibits lenders from requiring anyone to become obligated on a loan. The trustees would be needed to sign to represent the trust, but the individuals aren't needed in a legal capacity. If the trustees volunteer themselves, then they would be co-applicants.

Question 31. Could you define when does the creditor satisfy the 30-day requirement to notify the applicant of an approval? Is it based on a conditional approval letter or does it require the final approval letter? Conditional approvals could be conditioned on various issues. Would it make a difference if the condition was verification of income versus proof of hazard insurance?

Answer: When you notify the applicant that you anticipate making them a loan, you have met the 30 day requirement. You don't have to close the loan within 30 days, just notify them that you plan to close the loan. Obviously, you have verifications to complete and this decision can change if a verification (income, appraisal, credit report, etc.) provides negative information.

Question 32. During the discussion of joint applicant, on page 10, I believe you stated that a cosigner would only be treated as a joint applicant if the cosigner applies concurrently with the applicant, but not if the cosigner is brought in later because the creditor required one. Is this also true with a guarantor?

Answer: Yes. Keep in mind page 10 is discussing Regulation B and the prohibition of requiring someone to become obligated and the need to have evidence of joint applicant's intent to apply for joint credit [Section 202.7(d)].