Banker's Compliance Consulting

Compliance News...

Regulation B – Requiring Signatures on Loans . . .

Regulation B is very clear that lenders cannot require non-applying parties to become liable for debts. Most lenders know the general provisions of Regulation B or they have been in the game long enough to know the correct answer is, "we never require signatures". Although, lenders may not be blatantly requiring improper signatures, there may be policies, procedures or even software issues that directly conflict with the requirements of Regulation B. Unfortunately, the age old "we have always done it that way" is not a good defense.

To see exactly what Regulation B says about requiring signatures, we need to look at the following sections:

> §202.7(d)(1) states: *"a creditor shall not require the signature of an applicant's spouse or other person (other than a joint applicant) on any credit instrument (any legal liability document) if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested".*
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> §202.7(d)(5) states: *"if under a creditor's standards of creditworthiness, the personal liability of an additional party is necessary to support the credit requested, a creditor may request a cosigner, guarantor, endorser or similar party. The applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party".*

In a nutshell, these two sections state that a financial institution can require a cosigner or guarantor as a condition to extend credit. However, the financial institution cannot determine who the cosigner or guarantor will be.

Regulation B does allow a slight exception to this rule in the Commentary to §202.7(d)(6)#1 which states, *"a creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy".*

But read carefully, this exception has its limitations. It says financial institution can require a partner, director, officer or shareholder to personally guarantee a loan, but they cannot require them to sign the loan in a personal capacity.

On the surface, the difference between a personal guarantee and a personal signature may seem minimal. So, why all the fuss? When a partner, director, officer or shareholder of a business signs personally on a business loan, they are essentially a co-borrower with the business. From a legal perspective, co-borrowers and guarantors are treated very differently.

A co-borrower is primarily liable on a loan. If the primary borrower (in this case the business) defaults, the co-borrower is still liable and legally responsible to repay the loan. A guarantor, on the other hand, is not liable unless the borrower defaults and depending on the terms of the guarantee, the creditor has taken steps to collect the loan. To collect on a guarantee, the lender would have to prove the default by the borrower, which would not be the case with the co-borrower arrangement.

Seeing the differences in these two, it is safe to say that most lenders would want partners, directors, officers and shareholders to sign a note personally rather than obtain a personal guarantee. But, as we have already stated, Regulation B only allows you to ask for personal guarantees from these individuals. Of course, if an officer, director or shareholder offers to sign personally, they can. Just make sure that you evidence their intent to be jointly obligated. For more information on when and how to evidence joint intent, see our November 2007 and December 2007 newsletters.

[1] http://www.bankerscompliance.com/assets/files/newsletters/2007/November_2007.pdf

[2] http://www.bankerscompliance.com/assets/files/newsletters/2007/December_2007.pdf

CTRs and Sole Proprietors . . .

FinCEN recently issued Ruling FIN-2008-R001[1] which clarifies CTR completion guidance for Sole Proprietors and/or entities that operate under a "Doing Business As" (DBA) name. The ruling states that because a sole proprietorship is not a legal entity separate from the owner, financial institutions are only required to complete one section A. This Ruling also contains many examples of how the CTRs are to be completed. The information contained in FIN-2008-R001 differs from a previous FinCEN Ruling (FIN- 2006-R003[2]) which stated that a financial institution must complete two section A's. FinCEN has stated that they will accept CTRs completed in accordance with either Ruling.

[1]http://www.fincen.gov/fin-2008-r001.html

[2]http://www.fincen.gov/FIN-2006-R003.html

Don't Forget Your Phase II Biennial Renewals . . .

If you have Phase II exemptions, your biennial renewals must be filed and received at FinCEN by March 15, 2008. Be sure to remember the "effective date of the exemption" (Part I, Item 2) should be the date the original exemption was filed, NOT the date of the renewal. If an exempted business or payroll customer has had a change in control in the last two calendar years, be sure to mark the appropriate box (Part II, Item 11a). In Part V, you must sign the form and certify your *"system of monitoring… an exempt person for suspicious activity has been applied as necessary, but at least annually"*. It is important that you are conducting this monitoring and can prove it to your examiners.

Updating Your Financial Disclosure Statement . . .

If your institution is regulated by the FDIC or the OCC, you must make updates to your annual disclosure statement. This entails having year-end Call Report information for 2007 and 2006 available to the public by March 31, 2008. The annual disclosure statement must be signed by an authorized officer of the institution and include the following disclaimer:

> *"This statement has not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation."* [OCC regulated banks should state "Office of the Comptroller of the Currency"].

You are also required to post a notice in your lobby as to the public availability of the annual disclosure statement. The notice must be posted in the lobby of a bank's main office and at each branch.

CRA Public File Updates . . .

The Community Reinvestment Act (CRA) public file for your financial institution must be updated by April 1, 2008. This includes the public files kept at both the main office and each branch (if applicable). The following are some required file disclosures commonly overlooked:

- Any branches opened or closed by the financial institution in the current year and each of the prior two calendar years;
- Current services offered by the financial institution;
- Up to date transaction fees charged by the financial institution; and,
- For small and intermediate small financial institutions only, an up to date loan to deposit ratio for each quarter of the prior calendar year.

The branch file must include

- A copy of the public section of the bank's most recent CRA Performance Evaluation and a list of services provided by the branch; and,
- Within five calendar days of the request, all the information in the public files relating to the assessment area in which the branch is located.

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

The following Q & A's were generated by a recent "Applications" 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.

Pre-qualifications/Applications

Question 1. What do you do with pre-qualifications where the customer has never returned? How long do you keep them and how are we to document them?

Answer: The lender needs to demonstrate that it has exercised reasonable diligence to determine if the applicant wishes to proceed. If the applicant does not respond, the lender has no further regulatory responsibility. It is up to the bank as to how long they want to leave applications "open" for the applicant to respond. I have seen anything from 30 days to 6 months.

If the application is incomplete, the answer is a little different. Basically, the lender either needs to deny an application for incompleteness or request the information from the applicant. If the information is requested and the applicant does not provide it, the lender has no further responsibility.

Question 2. If we tell a consumer how much they are pre-qualified for, does this trigger the application requirements? Could we tell them, this is what they are pre-qualified for and the next step is to apply?
Question 3. If a loan officer issues a letter indicating a loan amount/purchase price the consumer is qualified to obtain (general) which is based on the verbal information given by the consumer, does it trigger RESPA and Truth in Lending disclosures? Credit approval?

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 needs to be sent.

Question 4. If during an inquiry specifics other than credit (i.e. income, property value, etc.) are discussed, is this considered an application?

Answer: You have an application when you have enough information to make a decision. If you are unable to make a decision based on the information discussed, there is no application.

Question 5. We have a prequalification program where we pull a credit report and if we determine they can qualify, we give a prequalification letter with an amount. If we do not think they qualify, we tell the individual that we need additional information and ask them to fill out an application form (FNMA 1003). Can we consider the latter scenario as an inquiry?
Question 6. 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: A 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. If you encourage them to proceed by completing an application and they indicate they will, you would not need to send an adverse action until the application was denied. If they choose not to proceed by completing an application, you would need to send an adverse action notice.

Denials

Question 7. For a completed application taken online and not approved, can we send an adverse action via email or an internet browser or must the adverse action go through the mail?

Answer: To send an adverse action notice by electronic means, you must comply with E-Sign rules.

Question 8. What about a phone call from 'Jim' telling you he is filing bankruptcy but wants to refinance, he does not give you any more information, i.e. last name, phone number, etc, but you say "hell no". Where do you send the adverse notice?
Question 9. 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 202.9(a) #7 states *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.* In short, you must try to obtain the information but if you unable to do so you cannot send an adverse action notice.

Question 10. How should a lender handle an oral application 'forced' on them away from the bank, say an oral application at a Chamber of Commerce mixer? Would an adverse action be necessary?

Answer: If you tell them "no", then technically you would need to send them a denial. However, I would recommend telling that person to come see you at the office or give them your business card. That way you make it known that you don't accept applications outside work hours.

Question 11. If an existing credit report is reviewed or a credit report is pulled in the pre-qualification process should it be treated as an oral application and send an adverse action if no application is completed?

Answer: Written applications are only required in a couple instances (home purchase, refinance and construction/perm). Even then, it is not the customer's responsibility to complete the written application. It appears that there is a request for credit (application) and something negative in the credit report is causing the lender to want to deny the loan. An adverse action notice would be required.

Pulling Credit Reports

Question 12. Does pulling a credit report in itself constitute an application?
Question 13. Does reviewing an existing credit report or pulling a credit report alone constitute an application? Or does any discussion about the member's credit in general (without reviewing the credit report) also constitute an application and therefore require an adverse action notice?

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

Application Date/Early Disclosures

Question 14. Which type of application triggers disclosures - an application or a completed application?

Answer: Disclosures are triggered by completed applications. Denials are triggered by communicating a "no" to an applicant.

Question 15. Can you verify under RESPA and TIL when disclosures are issued, is it 3 days or 3 business days when the application is provided?

Answer: Regulation Z (Truth in Lending) is clear that it is 3 **business** days when referring to the Preliminary Truth in Lending disclosure. "Business day" is defined in §226.2(a)(6) as *"a day on which the creditor's offices are open for carrying on substantially all of its business functions"*.

When it comes to RESPA, the term "business day" is defined the same as in Regulation Z. I think it is safe to think of this as Monday-Friday (even if you are open on Saturdays). I have not seen examiners push this issue.

Question 16. Do I need to give ARM disclosures with the application when the customer has not identified whether they want an ARM or fixed product?

Answer: If neither you nor the customer has mentioned an ARM, then the disclosure is not required. If it is discussed at all, provide the disclosure.

Question 17. 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: You can complete a new application but it is not necessary. I would recommend dating the application the date you originally receive it and then date it again when the house is identified.

Question 18. If the loan officer and borrower have spoken several times regarding a loan, but didn't know exactly what product would work and went ahead and ordered an appraisal, what would be considered the application date?

Follow-up: The borrower didn't know what or if they wanted to do a loan, but knew they wanted an appraisal, so the officer ordered the appraisal and the borrower finalized what they were going to do on 1/2/08 (after the appraisal was ordered).

Answer: It sounds to me that there was most likely a request for credit prior to the appraisal being ordered. The applicant and lender just weren't sure how much or what product. The appraisal would help determine that information. Based, on the information provided, I think the date the appraisal was ordered would be the application date. I think it would be difficult to argue "we ordered an appraisal but the customer wasn't requesting credit". If the customer just wanted to get an appraisal they could easily do that on their own.

Joint Intent

Question 19. If a husband and wife apply for joint credit and the wife gives the husband a POA to sign for her, does he have to initial for the joint credit on her behalf, or are his initials alone sufficient, since he would be initialing for her?

Answer: Technically, the joint applicants do not have to sign anything. The loan officer could document their intent in a file note. I think most banks have the customers sign/initial to evidence their intent and this is perfectly acceptable. In this instance, I think most banks would have the husband sign and then have him sign again as POA.

Question 20. I am confused on the joint applicant part, for the wife that comes in later and still receives benefits, but doesn't come in contemporaneously. How could she just be a cosigner instead of a joint applicant?

Answer: The wife can still be a joint borrower when the loan is signed but she may not be a joint applicant. If she was not intending to be on the loan when the application was first submitted, then she is not considered a "joint applicant" for purposes of Regulation B and documenting joint intent. However, you have the burden of proving that she was added to the application after the fact.

<u>Miscellaneous</u>

Question 21. What if the wrong app is given to a customer? They said they wanted a home improvement loan. Turns out it was for a couch and a gallon of paint. We collected GMI and didn't need it.

Answer: This would be an inadvertent collection and you should simply document it as such. Be careful that this does not happen on a regular basis. Make sure that the people handing out applications know what questions to ask the applicant to ensure they are distributing the correct application

Question 22. Do you recommend date stamping applications when they are 'received' versus using the date the customer signed it? The customer may have had it a week or more before delivering it to the bank.

Answer: I think this is an excellent practice. You wouldn't necessarily have to use a date stamp. A simple handwritten note documenting the date would suffice. You will save yourself many times over when auditors are looking through your files.

Question 23. If an application is submitted and denied, but a week later the applicant feels they have corrected the reason they were denied, is a new application necessary or can the old one be copied, changed as to the current request, and considered a new application? The idea is to save the customer time.

Answer: There are no regulatory rules regarding this scenario. I see no problem with this provided that you adjust the application date on the form. You may want to include a little note explaining why the date was changed.

Question 24. As an examiner, what do you say about the 'handwritten' 1003 and the final application which may not be signed by the loan officer, and because certain assets, that were declared by the applicants but not documented, were then left out on the final 1003 to be signed at closing.

Follow up: But under perjury, at closing, you are asking them to sign the application which is lacking some of the financial information.

Answer: I like to see written applications in the files, but I realize that some investors like them typed with all the verified information. There are many reasons that a final application may differ from the original such as incorrect information, unable to verify, etc. All the customer is doing at application is attesting to the fact that the information is correct. I don't see a huge issue with this.

Question 25. If an individual partially completes an internet application and does not submit it to the bank, the internet application vendor tracks these partially completed forms. How should we evaluate these partially completed applications and when should we consider them an application?

Answer: I would disregard them completely. If the individual did not submit them to the bank, they obviously did not want to submit a request for credit.

Question 26. What if we were to auto-populate a web application based upon info we know about the client?

Answer: I'm reluctant to answer this because there are too many questions and variables. Did the applicant initiate this? Once the auto-populating is completed, will you have enough information to make a decision or will you have an incomplete application?

If you know that they don't qualify, you have an application and must send a denial. If you don't yet have enough information, you don't have a complete application