FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

Atlanta Region
Division of Depositor & Consumer Protection
QUARTERLY NEWSLETTER

VOL12 ISSUE 3
September 2024

Third-Party Risk Management – A Guide for Community Banks

On May 3, 2024, the FDIC, along with the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, issued the Third-Party Risk Management, A Guide for Community Banks (Guide) as a resource to help community banks in developing and implementing their third-party risk management programs, policies, and practices.

Why was this done?

Community banks engage with third parties to help the banks compete in and respond to an evolving financial services landscape. Third-party relationships can offer community banks resources, including access to new technologies and risk management tools. A community bank's reliance on third parties, however, reduces its direct operational control over activities and may introduce new risks or increase existing risks, including but not limited to, operational, compliance, financial, and strategic risks. A community bank's use of third parties does not diminish or remove a bank's responsibility to perform all activities in a safe and sound manner, in compliance with applicable laws and regulations, including those related to consumer protection and security of customer information.

How does the Guide help?

This Guide is intended as a resource for community banks to consider when developing third-party risk management programs, policies, and practices by providing potential considerations and examples for each stage of the third-party risk management life cycle. The Guide is not a substitute for the Interagency Guidance on Third-Party Relationships: Risk Management. It is also not a checklist and does not prescribe specific risk management practices or establish any safe harbors for compliance with laws or regulations.

Unfair, Deceptive, and Abusive Practices

When evaluating a bank's Compliance Management System (CMS) and assigning a consumer compliance component rating, regardless of the bank's asset size, examiners will consider the effectiveness of the bank's risk management system to identify, address, and prevent consumer harm as it relates to unfair, deceptive, or abusive acts or practices. Consumer harm is defined as actual or potential injury or loss to a consumer whether such injury or loss is economically quantifiable (e.g., overcharge) or non-quantifiable (e.g., discouragement). Below is the first of a two-part series of articles covering unfair, deceptive, or abusive acts or practices.

Federal Trade Commission Unfair or Deceptive Acts or Practices (FTC UDAP)

Section 5 of the Federal Trade Commission (FTC) Act prohibits "unfair or deceptive acts or practices in or affecting commerce." The Federal banking agencies have authority to enforce Section 5 of the FTC Act (FTC UDAPs) regarding the institutions they supervise and their institution's affiliated parties. An act or practice may be unfair, deceptive, or both. The FTC Act's protection against FTC UDAPs extends to all consumers, including businesses.

Dodd-Frank Wall Street Reform and Consumer Protection Act UDAAP (Dodd-Frank UDAAP)

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 1031 of the Dodd-Frank Act provides authority to the Consumer Financial Protection Bureau (CFPB) to take enforcement, supervision, and rulemaking actions concerning unfair, deceptive, or abusive acts and practices by a "covered person" in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. Section 1036 of the Dodd-Frank Act prohibits a "covered person" from engaging in unfair, deceptive, or abusive acts or practices.

The FDIC Consumer Compliance Examination Manual contains information on Section 5 of the FTC Act and Sections 1031 and 1036 of the Dodd-Frank Act. The FDIC has supervisory and enforcement authority for state nonmember banks that includes both FTC UDAP and, in certain situations, Dodd-Frank UDAAP.

Standards for Determining what is Unfair or Deceptive

In general, for a finding of unfairness, a three-pronged test is applied. First, the act or practice in question must cause or likely to cause substantial injury to consumers. Second, the consumer must not be reasonably able to avoid the injury. Third, the injury must not be outweighed by countervailing benefits to consumers or to competition. Public policy, as established by statute, regulation, judicial decision, or agency determination, may be considered with all other evidence in determining whether an act or practice is unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair.

For a finding of deception, a separate three-pronged test is applied. First, there must be a representation, omission, or practice that misleads, or is likely to mislead the consumer. Second, the act or practice must be considered from the perspective of the reasonable consumer. In other words, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. When disclosures or marketing materials are targeted to a specific audience, their effect on a reasonable member of that audience is considered. Third, the representation, omission, or practice must be material, meaning it is likely to affect the consumer's decision to purchase or use the product or service.

Standards for Determining what is Abusive

Under the Dodd-Frank Act, there are stand-alone prohibitions for abusive acts or practices, which is unlike the FTC Act where all prongs of the test must be met. An abusive act or practice materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service, or takes unreasonable advantage of:

- a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;

- the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
- the reasonable reliance by the consumer or a covered person to act in the interests of the consumer.

The CFPB summarized the prohibition against abusive acts or practices at a high level as obscuring important features of a product or service, or leveraging certain circumstances to take unreasonable advantage.

Financial institutions should assess and understand their FTC UDAP and Dodd-Frank UDAAP risk profile. Heightened risk may be present in a variety of situations including where there are changes to a bank's products or services, the bank is offering a complex or atypical product, and the bank has marketing and delivery strategies using one or more third-party providers.

In the next quarterly newsletter, Part II of this two-part series will highlight some FDIC examination experiences and observed risk mitigation practices.

CFPB Extends Compliance Date for Small Business Lending Data Collection Rule

On March 30, 2023, the CFPB issued a final rule to implement Section 1071 of the Dodd-Frank Act (Section 1071). Section 1071 amended the Equal Credit Opportunity Act to require covered financial institutions to collect and report certain data on credit applications made by small businesses, including women- or minority-owned small businesses. According to the CFPB, the final rule would fulfil the statutory purposes to (1) allow Federal, State, and local enforcement agencies to assess potential areas for fair lending enforcement and; (2) enable a range of stakeholders to better identify business and community development needs and opportunities for small businesses, including women-owned and minority-owned small businesses.

Background

The final rule specifies a number of data points that lenders are required to collect and report. The final rule also provides the CFPB authority to require any additional data points that it determines would aid in fulfilling Section 1071's statutory purposes. In addition, the final rule contains a number of other requirements, including provisions that restrict access by underwriters and other persons to certain demographic and other data (i.e., firewall).

Section 1071 applies to:

- Covered financial institutions making at least 100 covered small business loans per year. Covered institutions include depository institutions (i.e., banks, savings associations, and credit unions), online lenders, platform lenders, merchant cash advance providers, and non-profit lenders;
- Diverse forms of credit that include closed-end loans, lines of credit, business credit cards, online credit products, and merchant cash advances; and
- Small businesses with gross revenue of $5 million or less in its preceding fiscal year.

Compliance Date Extension

On May 17, 2024, the CFPB announced its intention to extend the compliance deadlines for the final rule. The announcement came immediately after the U.S. Supreme Court's ruling in CFPB v. Community Financial Services Association of America, Ltd. (CFSA), in which the Supreme Court confirmed the CFPB's funding structure is constitutional. Lenders initially challenged the final rule in a Texas district court. The district court stayed the effective compliance dates of the rule for certain lenders pending the Supreme Court's decision in CFSA.

The stay was then extended to cover all small business lenders nationwide and the district court required the CFPB to extend the final rule's compliance deadlines to compensate for the period stayed if the CFPB won its case against the CFSA.

The CFPB extended the compliance dates as follows:

Compliance Tier	Original Compliance Date	New Compliance Date	First Filing Deadline
Tier 1 institutions (highest volume lenders)	October 1, 2024	July 18, 2025	June 1, 2026
Tier 2 institutions (moderate volume lenders)	April 1, 2025	January 16, 2026	June 1, 2027
Tier 3 institutions (smallest volume lenders)	January 1, 2026	October 18, 2026	June 1, 2027

The CFPB has published a number of additional materials and plain language resources to help lenders prepare for the new rule, including:

- CFPB's Small Business Lending Rulemaking Page
- CFPB Small Business Lending Rule Compliance Date Extension
- CFPB's Small Business Lending Resources

Adjustable Rate Mortgages – Disclosure and Accuracy Considerations

Over the last few years, we have identified findings regarding Adjustable Rate Mortgage (ARM) products, which in some cases have resulted in consumer harm. For this article and pursuant to Sections (§) 1026.20(c) and (d) of Regulation Z, which implements the Truth in Lending Act, an ARM is defined as a closed-end consumer credit transaction secured by a consumer's principal dwelling in which the annual percentage rate may increase after consummation.

This article serves as a reminder to financial institutions about the timing requirements for providing the initial and ongoing ARM disclosures, and the importance of ensuring the interest rate stated on each disclosure is calculated in accordance with the legal terms of the ARM loan contract. The information in this article may provide financial institutions with useful insights as they offer ARM products to their customers.

For ARMs with terms greater than one year, Regulation Z generally requires ongoing interest rate adjustment disclosures under §1026.20(c) and initial interest rate adjustment disclosures under §1026.20(d). There are general rules governing the delivery timeframes of the disclosures; however, the rules provide several exemptions. A summary of the general disclosure delivery timeframes is detailed in the following table.

For ARMs…	§1026.20(c) Ongoing Interest Rate Adjustment Disclosure Notice Due…	§1026.20(d) Initial Interest Rate Adjustment Disclosure Notice Due…
General Rule: ARM Disclosure Notice Requirements	60 – 120 days before the first payment at the adjusted level is due for each rate adjustment causing a payment change	210 – 240 days before the first payment at the adjusted level is due for the initial adjustment

If the first payment at the adjusted level is due within the first 210 days following loan consummation	60 – 120 days before the first payment at the adjusted level is due for each rate adjustment causing a payment change, but only if the new interest rate disclosure required by §1026.20(d) at consummation was an estimate	At loan consummation
Frequently adjusting ARMs: If uniformly scheduled interest rate adjustments occur every 60 days or more frequently (i.e., adjust regularly at a maximum of every 60 days)	25 – 120 days before the first payment at the adjusted level is due for each rate adjustment causing a payment change	Depends on the due date of the first payment at the adjusted level: • If due within the first 210 days following loan consummation, at loan consummation. • If greater than 210 days following loan consummation, then 210 – 240 days before the first payment is due at the adjusted level (see "General Rule" above)
ARMs originated prior to January 10, 2015, with short lookback periods (i.e., the adjusted interest rate and payment are calculated based on an index figure available less than 45 days prior to the adjustment date)	25 – 120 days before the first payment at the adjusted level is due for each rate adjustment causing a payment change	
ARMs adjusting soon after consummation: ARMs with first rate adjustment within 60 days of consummation and the §1026.20(d) initial disclosure provided at consummation contained an estimated new interest rate	For the first adjustment to this type of ARM, as soon as practicable, but not less than 25 days before the first payment at the adjusted level is due. Subsequent ongoing notices depend on the future scheduled interest rate adjustments according to this table.	

Historically, many ARM loan contracts reference the index change date as "the most recent index figure available as of the change date" or "the most recent index figure available as of the date 45 days prior to the change date." The timeframe financial institutions utilize to review an index is commonly referred to as the lookback period. Examiners identified instances where financial institutions confused the disclosure delivery timeframe of 60 days with the lookback period in the loan contract or thought the 60 days took precedence over the lookback period. Additionally, some financial institutions sent the §1026.20(c) notices (hereafter referred to as payment change disclosures) 60 days prior to the rate change date instead of prior to the first payment due date with the new rate and payment, resulting in the application of an incorrect index value. Let's look at an example.

Loan Contract Calls For:	Rate Change Example
Loan Contract Date	May 1, 2022
Rate Change Frequency	Annually
Index Change Date	45 days prior to the change date (May 17, for this example)
Rate Change Date for Loan	July 1
New Payment Due Date	August 1
Delivery Time of Disclosure	May 17 – June 2

Based on the loan contract, the index figure available on May 17 should be used for the rate, as this is 45 days prior to the change date of July 1. According to the regulation (shown in the first table in this article), the payment change disclosure

must be provided at least 60, but no more than 120, days prior to the first payment due date at the new rate (between April 3 and June 2 in this example). However, since the index figure is not available until May 17, the payment change disclosure cannot be sent prior to May 17. As a result, the institution could provide the payment change disclosure any time during the period of May 17 (the date the index value becomes known) to June 2 (the latest date that the disclosure can be sent) to comply with the disclosure timing requirements.

Examiners have also identified violations where the §1026.20(c) and §1026.20(d) notices stated a new interest rate that was not calculated in accordance with the legal terms of the loan contract. The miscalculation resulted in consumer harm as the new interest rate assessed on the ARM loan was higher than it should have been according to the contract. In some cases, the financial institutions provided restitution to harmed borrowers. The following are examples of issues that have led to financial institutions incorrectly calculating the new interest rate.

- The loan contract indicated the index value in effect 45 days prior to the change date would be used to calculate the new interest rate; however, the loan system parameters were incorrectly set up to reference the index value on a different date (such as the change date).
- Rate limitation settings, such as rate caps, were incorrectly set up in the loan system parameters.
- The index specified in the loan contract was not used to calculate the new interest rate. For instance, the loan contract specified that the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of 1 year would be used; however, the monthly average yield was used instead.
- Changes to the index value were not input into the core processing or loan operating system, which resulted in a stale value being used to calculate the new interest rate.

An effective compliance management system includes procedures and processes that adequately guide and support the activities related to ARM rate changes. Additionally, a comprehensive monitoring or audit function verifies that the core processing or loan system parameters accurately reflect the terms of the loan contracts.

Community Affairs Corner

Strategies to Address Affordable Housing Challenges

Mortgage lending is an important element of many insured depository institutions' business strategies and is often one of the primary product lines reviewed during Community Reinvestment Act (CRA) evaluations. However, "Nearly Half of U.S. Households Can't Afford a $250,000 Home.[1]" This was the headline of a May 17, 2024, publication by the National Association of Home Builders (NAHB). NAHB further reported that, while the nationwide median price of a new single-family home was $495,750, approximately 66.6 million households could not afford a $250,000 home. A primary reason for the lack of affordability is the significant rise in inflation, including for affordable housing, compared to the low increase in income, particularly for families of color[2]. Financial institutions can play a major role in addressing the affordability challenges faced by low- and moderate-income (LMI) individuals and communities and may wish to consider some of the strategies detailed below.

The FDIC continues its commitment to economic inclusion, as outlined in the newly updated Economic Inclusion Strategic Plan (EISP) that was released in April 2024. The EISP shares strategies for addressing affordable housing for LMI

[1] National Association of Home Builders 2024, Nearly Half of U.S. Households Can't Afford a $250,000 Home NAHB, accessed 27 August 2024.

[2] Jeffrey C. Fuhrer 2024, The cost of being poor is rising. And it's worse for poor families of color. Brookings, accessed 27 August 2024.

individuals and communities by encouraging financial institutions to partner with federal, state, and local government programs and those offered by non-profit organizations to benefit LMI and underserved consumers.

When exploring such partnerships, financial institutions should be aware of the potential CRA implications. As outlined in the FDIC's CRA regulations at 12 CFR 345, a bank may receive consideration for a loan, investment, or service that supports community development, including through affordable housing, which encompasses:

- rental housing,
- multifamily housing with affordable rents,
- one-to-four family rental housing with affordable rents in a non-metropolitan area,
- affordable owner-occupied housing for LMI individuals, and
- housing-related bonds or securities that primarily address affordable housing needs for LMI individuals.

Several other community development activities may qualify, including activities with:

- Minority Depository Institutions,
- Women-Owned Depository Institutions,
- Low-Income Credit Unions, or
- Community Development Financial Institutions[3].

One specific area in which financial institutions can have a great impact is in addressing affordable housing challenges. This is the case with temporary or rental housing, or with respect to homeownership opportunities that help potential homebuyers find an affordable mortgage. Financial institutions can offer affordable mortgage lending products to a wide range of customers, thereby expanding their bank-customer relationships and demonstrating that the institution is interested in helping the borrower build financial success. For example, financial institutions can make available prudently underwritten, affordable, and responsible mortgage credit for LMI households, whether through Special Purpose Credit Programs or other credit enhancement programs.

Additionally, insured depository institutions can provide affordable housing opportunities for LMI borrowers by offering a broader range of prudent and responsive products and services. Affordable mortgage credit workshops, such as those offered by federal agencies, government-sponsored enterprises, or national housing leaders, can also be explored. These types of workshops are designed for community banks and others interested in single-family mortgages to learn more about innovative products and programs from federal and other sources to expand access to affordable mortgage credit to LMI households and other underserved populations.

To learn more about how Community Affairs staff can help your financial institution implement strategies to address affordable housing and affordable mortgages for LMI individuals and communities, contact your FDIC Regional Manager, LaTonya M. Edwards, at latedwards@fdic.gov. The FDIC offers additional resources related to affordable mortgages through the Affordable Mortgage Lending Center, which includes links to other federal agencies and Government-Sponsored Enterprise programs and products.

[3] https://www.ecfr.gov/on/2024-03-29/title-12/chapter-III/subchapter-B/part-345

Upcoming Atlanta Community Affairs Events

To view and register for all Community Affairs event visit Community Affairs Events

FDIC Hosts Webinar Series - Digital Equity Insights: Expanding Economic Inclusion for Stronger, Digitally-Inclusive Communities
October 9, 2024, from 1:00 PM – 2:30 PM ET – *Victor Galloway*
Webinar #3 of 4: Encouraging Opportunities for Economic Inclusion – Addressing Digital Inequity. Join us in the third of four interactive webinars, as we highlight market activity and foster meaningful connections between local stakeholders and a region-wide ecosystem for lending, investment, and service opportunities. This session will orient participants to programs and strategies for affordable broadband investment, device access, and key roles to support program integration, as well as implementation to effectively assist marginalized families and communities.

FDIC Hosts Overcoming Financial Barriers for Persons with Disabilities
October 16, 2024, from 9:00 AM – 11:00 AM ET – *Rhonda Little*
The Federal Deposit Insurance Corporation will host a webinar to promote awareness among community-based organizations, employers, and other stakeholders working with consumers with disabilities. The speakers will highlight exciting programs and provide resources that can help support those with disabilities and low- and moderate-income (LMI) individuals. Presenters will also discuss collaborations, partnerships, strategies, and resources that can stimulate awareness and capabilities of financial challenges facing persons with disabilities.

FDIC Hosts Webinar Series - Digital Equity Insights: Expanding Economic Inclusion for Stronger, Digitally-Inclusive Communities
October 29, 2024, from 1:00 PM – 2:30 PM ET – *Terry Lee*
Webinar #4 of 4: Leadership for the Future – Roadmap for Sustainable Inclusion. Join us in the last of four interactive webinars as industry leaders explore scalable approaches to mobilize banks and financial intermediaries for a sustainable approach across the Southeast.

If you are interested in obtaining information regarding any previous or upcoming events or for general questions or inquiries, please send an email to atlcommunityaffairs@fdic.gov.

Recent Publication Highlights

Press Releases

- Agencies Issue Final Rule to Help Ensure Credibility and Integrity of Automated Valuation Models (PR-56-2024)
- Agencies Finalize Interagency Guidance on Reconsiderations of Value for Residential Real Estate Valuations (PR-57-2024)
- FDIC Board Approves Proposed Rule to Revise Brokered Deposit Regulations (PR-65-2024)

Financial Institution Letters

- 2023 Financial Institution Diversity Self-Assessment: Voluntary Self-Assessments Accepted Now through October 31, 2024 (FIL-44-2024)
- Agencies Issue Statement on Bank Arrangements with Third Parties to Deliver Deposit Products and Issue Request for Information Seeking Input on Bank-Fintech Arrangements (FIL-45-2024)
- Classification of Interactive Teller Machines as Domestic Branches or Remote Service Units (FIL-53-2024)
- Questions and Answers Regarding FDIC Official Signs and Advertising Requirements, False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC Name or Logo (FIL-56-2024)