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US Regulation of Bank Lending

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Introduction

The lending activities of banks in the United States are regulated by a complex, interconnected network of federal and state laws and regulations.[1] This regulatory framework is designed to simultaneously ensure the continued safety and soundness of banking organizations and protect the interests of consumers. The framework is in some ways different than that for nonbank lenders. This outline focuses on the regulatory framework for bank lending.

Lending is a "Core Banking" Function

Lending is one of the core features and defining characteristics of a "bank" and of a "branch" of a bank (along with accepting deposits, paying checks, and engaging in fiduciary activities) under the Bank Holding Company Act (BHC Act), the International Banking Act, the National Bank Act, the Federal Deposit Insurance Act (FDI Act), and state banking laws. Lending is one of the essential powers of a commercial bank, and — although nonbanks are also permitted to engage in lending activities — one of the functions viewed as a central part of the "business of banking."

Some state laws that impose licensing requirements and regulations on lenders exclude banks (although, in some cases, not out-of-state banks) from coverage based on the theory that their lending activities are already regulated under federal and state banking laws. Lending across state lines by an out-of-state bank is also generally excluded from state "doing business" qualification requirements under corporate statutes that impose such requirements on out-of-state "foreign" corporations.

Principles of Safe and Sound Banking

- Under the FDI Act, federally and state-chartered banks and thrift institutions are prohibited from engaging in unsafe and unsound banking practices, including those relating to banks' lending

[1] In October 2014, we discussed key governing statutes, rules and areas of law governing banks' deposit-taking function in our client bulletin "U.S. Regulation and Structure of Deposit Products." Arnold & Porter LLP, U.S. Regulation and Structure of Deposit Products (Oct. 2014), *available at* http://www.arnoldporter.com/resources/documents/ADV914UsRegulationAndStructureOfDepositProducts2.pdf.

activities.[2] Action or lack of action by a bank's directors or management constituting "unsafe or unsound" banking practices can lead regulators to impose corrective measures, including, for example, the issuance of a cease-and-desist order or termination of the bank's deposit insurance coverage.[3] Furthermore, a bank's directors and management may be held personally liable for misconduct jeopardizing the bank's safety and soundness.[4]

- To assist banks in conforming to these requirements, the FDI Act requires the federal banking agencies to establish safety and soundness standards relating to specific bank lending activities — including standards for credit underwriting, interest rate exposure, loan documentation, loan application review and approval, and the administration of loan agreements.[5]

- Violations of these safety and soundness standards, as well as certain of the prudential lending limitations discussed below (for example, limits on loans to one borrower and restrictions on affiliate and insider lending), can result in corrective action by the Federal Deposit Insurance Corporation (FDIC) or other federal banking agencies.

- A bank's risk management and internal controls must include policies and procedures that account for the general risks associated with lending — most notably credit and interest rate risk — as well as risks relating to specialized forms of lending, such as installment, credit card, and leveraged lending.[6]

- In addition, the banking agencies have published guidance on safety and soundness criteria for banks engaged in these specialized forms of lending. For example, the OCC has issued detailed guidance on specific lending activities (such as commercial real estate lending, leveraged finance, small business lending, and residential mortgage lending) and on certain structural aspects of lending

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2 12 U.S.C. §§ 1811 *et seq*. The Federal Deposit Insurance Corporation's Risk Management Manual of Examination Policies notes "[t]he concept of unsafe or unsound practices is one of general application . . . [and] it would . . . be virtually impossible to catalog with a single all inclusive or rigid definition, the broad spectrum of activities which are included by the term." Courts, however, generally define "unsafe and unsound practices" as "conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to [the] banking institution or shareholder." *Northwest Nat'l Bank v. U.S. Dept. of Treas.*, 917 F.2d 1111, 1115 (8th Cir. 1990).

3 *See* 12 U.S.C. § 1818.

4 *See id.* § 1818(b)(6); *see also del Junco v. Conover*, 682 F.2d 1338 (9th Cir. 1982) (recognizing the authority of the Comptroller of the Currency to issue a cease and desist order on a bank director — authority which was later expanded upon under the Financial Institutions Reform, Recovery and Enforcement Act of 1989).

5 *See generally* 12 U.S.C. § 1831p-1; Interagency Guidelines Establishing Standards for Safety and Soundness, 12 C.F.R. pt. 364, Appx. A.

6 *See* Office of the Comptroller of the Currency (OCC), Comptroller's Handbook, Safety and Soundness (2011).

arrangements (such as appraisals and fair valuation, the use of credit scoring models, and assessing counterparty credit risk).[7]

Usury Law and the Most Favored Lender Doctrine

- Usury laws impose limitations on the interest rates that banks may charge for consumer and commercial loans and are largely enforced at the state level. However, state usury laws may apply to both federally and state-chartered banks.

- "Interest" generally includes the payment received by a lender for the purpose of any extension of credit and is ordinarily measured at the time a loan is made. Interest can include a variety of payments, such as numerical periodic rates, late fees, and overdraft fees, but may exclude payments such as credit insurance premiums and certain administrative fees.[8]

- Federally-chartered, or national banks, are permitted to charge an interest rate on a loan that is the greater of:
    - The rate allowed by the state in which the bank is located; or
    - One percent above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district.

- If the state in which the bank is located does not establish a usury limitation, the bank may charge the greater of:
    - Seven percent; or
    - One percent above the discount rate on 90-day commercial paper in effect in the bank's Federal Reserve district.[9]

- Under the "Most Favored Lender Doctrine," national banks generally are permitted to (i) use the most favorable interest rate allowed to state banks under state law or (ii) export the maximum interest rate limit that a national bank uses in its home state for purposes of transacting with customers in another state.

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7 *See Commercial Credit*, OCC (2015), http://occ.treas.gov/topics/credit/commercial-credit/index-commercial-credit.html; *Retail Credit*, OCC (2015), http://occ.treas.gov/topics/credit/retail-credit/retail-credit-issuances.pdf.

8 12 C.F.R. § 7.4001(a).

9 12 U.S.C. § 85.

- In general, state-chartered banks are permitted to use the same interest rate as national banks. If a state usury law inhibits a bank from applying the same interest rate as a national bank, 12 U.S.C. § 1831d(a) preempts such a state law, thereby affording state-chartered banks the same options as national banks.

Limits on Loans to One Borrower

- Under federal law, the amount of credit that national banks are permitted to extend to one borrower or to a group of related borrowers is capped, subject to particularized exceptions which are tailored to the nature and type of a loan.

- In general, the maximum amount of credit that a national bank, federal savings bank, or thrift institution may extend to any one borrower is:
    - 15 percent of the bank's unimpaired capital and surplus; and, if applicable
    - An additional 10 percent of the bank's unimpaired capital and surplus for extensions of credit which are fully secured by readily marketable collateral — which means financial instruments and bullion that are salable under ordinary market conditions with reasonable promptness at a fair market value (together, the General Limits).[10]

- Certain transactions are not considered "extensions of credit" for the purpose of calculating the applicable loan limitation, including:
    - Funds advanced for the benefit of a borrower for payment of taxes, insurance, utilities, security, and maintenance and operating expenses for the purpose of preserving the value of real property securing a loan;
    - Accrued or discounted interest;
    - Financed sales of a bank's own assets;
    - A renewal or restructuring of a loan as a new extension of credit provided that no new funds are advanced by the bank and no new borrower replaced the old borrower;
    - Amounts paid against uncollected funds in the normal process of collection;
    - Portions of a loan sold as a participation on a nonrecourse basis, provided that credit risk is shared proportionately; and

[10] *Id.* § 84; *see also* 12 C.F.R. § 32.2(v). We note that specified categories of loans that satisfy certain conditions are subject to no lending limit, including, for example, loans arising from the discount of commercial paper and loans secured by US obligations or guaranteed by a federal agency. 12 C.F.R. § 32.3(c).

- o Portions of a loan, not exceeding 10 percent of capital and surplus, for which the bank has purchased protection in the form of a single-name credit derivative.[11]

- In addition to the General Limits, banks may make loans to one borrower not exceeding 10 percent of capital and surplus if such loans are secured by livestock, the discount of paper by dealers in dairy cattle, or the discount of installment consumer paper.[12] Furthermore, a bank may make a loan of up to 35 percent of its capital and surplus, in addition to the General Limits, if the loan is secured by a bill of lading or warehouse receipt covering readily marketable staples.[13]

- Under the lending limits attribution rule, certain loans made to one borrower may be attributed to other persons, who will themselves be deemed borrowers for purposes of calculating the applicable lending limit. For example, if the proceeds of a loan obtained by one borrower will be for the direct benefit of another person, those proceeds will generally be attributed to the other person for purposes of the lending limits.[14] Similarly, the lending limits attribution rule applies where loans to separate borrowers will be aggregated when the expected source of repayment is the same for each borrower or where the borrowers are under common control and are substantially financially interdependent.[15] The attribution rule often applies when banks make loans to partnerships or joint ventures and where at least one of the "direct benefit" or "common enterprise" conditions is satisfied.

- Banks must conform to special rules when making loans to corporations or limited liability companies. Banks may not make a loan to a "corporate group" — *i.e.*, any person or entity which owns at least 50 percent of the voting securities or interests of an entity — that would exceed 50 percent of the bank's capital and surplus, in the aggregate.[16]

- State-chartered banks must conform to applicable state law establishing limitations on loans to one borrower, which tend to be comparable to the federal limitations across jurisdictions.

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11 12 C.F.R. § 32.2(q)(2)(i)-(vii).

12 *Id.* § 32.3(b)(2)-(4).

13 *Id.* § 32.3(b)(1).

14 *Id.* § 32.5(b).

15 *Id.* § 32.5(c).

16 *Id.* § 32.5(d).

Restrictions on Lending to Insiders

- Regulation O of the Board of Governors of the Federal Reserve System (FRB) sets forth federal rules governing banks' loans to insiders — *i.e.*, an executive officer, director, senior policy-making manager, or principal shareholder (at least a 10 percent owner) of the bank or the bank's subsidiaries, parent company, or parent company subsidiaries and any related interest of such a person.[17]

- Certain general requirements apply to all insider loans by banks, including:[18]
  - Loans must be made on market terms, *i.e.*, similar to those made to non-insiders;
  - The bank's board of directors must pre-approve any insider loan which exceeds the greater of $25,000 or five percent of the bank's unimpaired capital and surplus (or, in the aggregate, the extension of credit to one insider exceeds $500,000);
  - The bank must conform to the applicable loan-to-one-borrower limitation, discussed above; and
  - The total amount of loans to all insiders must not be greater than the bank's unimpaired capital and surplus — however, a bank may extend a total loan amount of up to twice this amount if it has $100 million or fewer in total deposits, is adequately capitalized, and its board of directors authorizes the higher limit and substantiates its decision as being consistent with safe and sound banking practices.

- Additional requirements for executive officers and directors include:[19]
  - The bank may not provide overdraft services to an executive officer or director unless it is pursuant to a written pre-authorized credit plan or transfer of funds from another of the individual's accounts with the bank.
  - There are also specialized loan limits, documentation, and reporting requirements for loans to executive officers, including:
    - A bank may not extend credit to executive officers which, in the aggregate, exceeds the greater of $25,000 or two and a half percent of the bank's unimpaired capital and surplus — and an extension of credit to an executive officer may never exceed $100,000;

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17 12 C.F.R. § 215.2(h).

18 *Id.* § 215.4.

19 *Id.* § 215.5.

- These loan limits do not apply to loans that are (i) used to finance the education of the executive officer's children, (ii) used to finance or refinance the purchase of or related investments in the executive officer's residence, or (iii) secured by certain perfected security interests or by a segregated account.

- Any loan to an executive officer must:
  - Be preceded by a current financial statement provided by the executive officer;
  - Conform to the market terms and creditworthiness provisions of 12 C.F.R. § 215.4(a);
  - Be reported to the bank's board of directors; and
  - Be subject to a demand clause which enables the bank to declare the loan due and payable at any time.

- The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) imposed additional requirements on insider lending by banks. For example, the Dodd-Frank Act:
  - Requires that credit exposure to derivatives be treated as a loan for purposes of the applicable restrictions;[20]
  - Adds new restrictions on asset purchases and sales between a bank and an insider;[21] and
  - Amends the Federal Reserve Act (FRA) to include certain derivative and securities lending transactions within the definition of "extension of credit."[22]

- Banks must keep detailed records of insiders' total outstanding loans with the bank and may be required to disclose publicly loans made to executive officers and directors.[23]

Restrictions on Lending to Affiliates

- Sections 23A[24] and 23B[25] of the FRA and Regulation W[26] restrict lending and other extensions of credit by a bank directly or indirectly to its affiliates.

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20 12 U.S.C. § 84(b).

21 12 U.S.C. § 375b.

22 *Id.*

23 12 C.F.R. § 215.8.

24 12 U.S.C. § 371c.

25 *Id.* § 371c-1.

- Section 23A imposes the following restrictions on transactions with affiliates:[27]
  - A bank's aggregate covered transactions with *any one* affiliate cannot exceed 10 percent of its capital and surplus;
  - A bank's aggregate covered transactions across *all* affiliates cannot exceed 20 percent of the bank's capital and surplus;
  - Extensions of credit, letters of credit, guarantees, and cross-affiliate netting arrangements must be fully secured by eligible collateral (ranging from 100 percent to 130 percent of the committed amount, depending on the type of collateral); and
  - A bank cannot purchase a "low quality asset" — *e.g.*, a substandard, risky asset as determined by a supervising regulator or a loan which is unsatisfactory because of past due payments — from an affiliate.

- Section 23B imposes certain additional restrictions on transactions with affiliates including the following:[28]
  - A bank must transact with an affiliate at "arm's length" or on market terms;
  - A bank may not act in a fiduciary capacity when purchasing any security or asset from an affiliate unless the purchase is permitted under the instrument creating the fiduciary relationship, by court order, or by governing law;
  - When acting as a principal or fiduciary, a bank generally may not purchase or acquire securities from an affiliate if the affiliate is the principal underwriter of the securities; and
  - A bank may not publish any advertisement or enter into any agreement stating or suggesting that the bank will be responsible for the obligations of its affiliates.

- The application of Sections 23A and 23B was expanded under the Dodd-Frank Act and its "Volcker Rule." If an insured bank manages, advises, or sponsors a "covered fund" (defined to include a hedge fund, private equity fund, or other privately placed investment fund that relies on Sections 3(c)(1) or 3(c)(7) for an exemption from the Investment Company Act (ICA) or a similar private commodity pool), the bank, its parent holding company and its affiliates may not lend to or enter into other affiliate transactions with the hedge fund or private equity fund under Sections 23A and 23B.[29]

Footnote continued from previous page

[26] *See generally* 12 C.F.R. pt. 223.

[27] *See generally id.* pt. 223, Subpart B.

[28] *See generally id.* pt. 223, Subpart F.

[29] 12 U.S.C. § 1851(f).

- Certain of the securities laws also apply to affiliate transactions. Under Section 17 of the ICA, if a bank or its affiliate serves as the principal underwriter or investment adviser to a registered investment company or is otherwise an "affiliate" under the ICA,[30] the bank and its affiliates are prohibited from engaging in acts of "self-dealing," including borrowing from or lending to the investment company.[31] This ICA restriction further limits lending by a bank to an investment company advised or distributed by the bank or the bank's affiliates.

Margin Lending Restrictions

- Securities credit is regulated by the FRB under the margin rules, Regulations T, U, and X.

- Under Regulation U, banks are prohibited from extending margin loans in an amount that exceeds the maximum loan value of the collateral securing the credit. Regulation U applies only if "purpose credit" is extended and secured by "margin stock."[32]

- Regulation U imposes a number of requirements on bank securities lending, including obtaining "purpose statements" on Form FR U-1 from customers and a limit on the maximum loan value of purpose credit extended against margin stock. The maximum loan value of any margin stock is 50 percent of its current market value. The maximum loan value of non-margin stock and, generally, all other collateral is the "good faith loan value," which is the amount, not exceeding 100 percent of the current market value of the collateral, which the lender would extend while exercising sound credit judgment.[33]

    - Securities broker-dealers, in contrast, are subject to Regulation T[34] and Financial Industry Regulatory Authority (FINRA), margin rules as well as to a Securities and Exchange Commission

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30 *See* 15 U.S.C. § 80a-2(a)(2)-(3) (defining "affiliated company" and "affiliated person," which include, generally, any director, officer, or employee of the investment company and any person owning 5 percent or more of the investment company's voting securities, any person in which the investment company owns 5 percent or more of the voting securities, or any person controlled by or under common control with the investment company).

31 *See generally id.* § 80a-17.

32 12 C.F.R. § 221.3(a). "Purpose credit" is credit for the purpose, whether immediate, incidental, or ultimate, of carrying margin stock. "Margin stock" includes: (i) any equity security registered or having unlisted trading privileges on a national securities exchange; (ii) any OTC security traded in the national market system; (iii) any debt security convertible into a margin stock; (iv) any warrant or right to subscribe to or purchase a margin stock; or (v) any security issued by an investment company registered under Section 8 of the ICA.

33 *Id.* § 221.7.

34 *See generally* 12 C.F.R. pt. 220.

(SEC) disclosure rule for margin loans that was adopted in 1969 at the same time as Regulation Z, but has not been amended since.[35] Regulation T is in many ways more restrictive than Regulation U. Lending by broker-dealers and their affiliates (including their bank affiliates) during the period of a public offering in which the broker-dealer participates is restricted by Section 11(d) of the Securities Exchange Act of 1934 (Exchange Act) and SEC Rules 11d-1-1 *et seq*. under that Act.

- Nonbank and non-broker-dealer lenders of securities-related credit are subject to Regulation U and must register with the FRB. Previously they were subject to Regulation G. Borrowers of securities-related credit are subject to the FRB's Regulation X.[36]

Regulation of Loan Securitization

- Although whole loans normally are not treated as "securities" under the Securities Act of 1933 (Securities Act) and the Exchange Act (but typically are viewed as "securities" under the Investment Advisers Act and ICA), loan securitization by banks and others has long been subject to requirements under the federal securities laws. These include disclosure and periodic reporting requirements, obligations to register the securities with the SEC or conform to an exemption from registration, and requirements regarding the status of the pool under the ICA.

- Some of these securities law requirements are specially tailored for loan securitizations,[37] while others are more general in nature but are commonly used for loan securitizations.[38]

- The Dodd-Frank Act imposed several new requirements on loan securitizations. These include the still-pending "conflicts of interest" prohibition in Section 621 of the Dodd Frank Act, codified in Section 27B of the Securities Act, and proposed to be implemented by SEC rule 127B, as well as the diligence, representations and warranties and disclosure requirements added by Sections 942, 943 and 945 of the Dodd Frank Act, codified in Section 7 of the Securities Act and Sections

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35 17 C.F.R. § 240.10b-16.

36 *See generally* 12 C.F.R. pt. 224.

37 *See, e.g.*, ICA § 3(c)(5)(C); Rule 3a-7 under the ICA; Rules 139a and 167 under the Securities Act; Rules 3a12-1, 3a12-4 and 3b-19 under the Exchange Act.

38 *See, e.g.*, ICA § 3(c)(7); Rule 144A under the Securities Act.

15(d) and 15G of the Exchange Act and implemented by Regulation AB and various other SEC rules adopted in 2011 and 2014.[39]

- Also added to the regulatory framework governing loan securitizations is the "credit risk retention" (more popularly known as the "skin in the game") requirement in Section 941(b) of the Dodd-Frank Act, codified in Section 15G of the Exchange Act and implemented by certain SEC-led interagency rules.[40] These provisions require the lender or securitizer to maintain an equity interest in the pool. The intent of the requirement is to reduce the moral hazard potential from making imprudent loans with a view toward quickly selling them. The statute and implementing rules contain an exemption from the "skin in the game" requirement for securitizations of Qualified Mortgage (QM) loans.

- In addition, the Volcker Rule and the interagency rules implementing it, which restrict banks' and their affiliates' investments in and relationships with private investment funds that rely on Sections 3(c)(1) and 3(c)(5) of the ICA, contain exemptions for loan securitizations[41] and asset securitizations.[42] Whole loans generally are not "financial instruments" in which proprietary trading by banks and their affiliates is restricted by the Volcker Rule.

Anti-Tying Rules

- The BHC Act prohibits banks from requiring their customers to obtain any product or service as a condition to the extension of credit.[43]

- The prohibition applies to nonbank products and services, additional lines of credit of the bank, its holding company, or subsidiaries of the holding company or a line of credit, property, or other service provided by a competitor.

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39 Issuer Review of Assets in Offerings of Asset-Backed Securities, 76 Fed. Reg. 4231 (Jan. 25, 2011); Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Act, 76 Fed. Reg. 4489 (Jan. 26, 2011), Suspension of the Duty to File Reports for Classes of Asset-Backed Securities Under Section 15(D) of the Exchange Act, 76 Fed. Reg. 52,549 (Aug. 23, 2011); Asset-Backed Securities Disclosure and Registration, 79 Fed. Reg. 57,184 (Sept. 24, 2014).

40 *See* 12 C.F.R. pts. 43, 244, 373, and 1234; 17 C.F.R. pt. 246; 24 C.F.R. pt. 267; *see also* Credit Risk Retention, 79 Fed. Reg. 77,602 (Dec. 24. 2014).

41 *See* 12 C.F.R. §§ 44.10(c)(8), 248.10(c)(8), and 351.10(c)(8); 17 C.F.R. § 255.10(c)(8).

42 *See* 12 C.F.R. §§ 44.11(b), 248.11(b), and 351.11(b); 17 C.F.R. § 255.11(b).

43 12 U.S.C. § 1972.

- The FRB has issued guidance establishing that certain arrangements are not "tying arrangements" for purposes of the BHC Act. The arrangements include, for example:[44]
  - Joint offerings of products or services if acceptance of one product or service is not conditioned on acceptance of the other;
  - Customer-initiated tying arrangements;
  - Arrangements of nonbank subsidiaries;
  - Certain arrangements under which the price or availability of a desired product or service is conditioned on the purchase or use of a "traditional" bank product or service — *e.g.*, a loan, discount, deposit, or trust service — provided that the traditional bank product or service is the tied product or service;
  - Arrangements involving products which are related to, and usually provided in connection with, a traditional bank product; and
  - Certain mixed-product arrangements, provided that the customer can choose at his or her discretion whether the condition is satisfied by a bank or nonbank product or service.

- The FRB also has granted certain regulatory safe harbors, including the "combined-balance discount" safe harbor — which permits a bank to discount a product and/or service based on the customer's maintaining of a certain minimum account balance. There is also a foreign transactions safe harbor.[45]

- The anti-tying statute creates a private right of action and is commonly used by borrowers against bank lenders in the context of actions by a bank to enforce or collect on a loan.

Consumer Lending Disclosure Obligations

- The Truth in Lending Act (TILA) and Regulation Z impose disclosure requirements when providing consumer credit, which is credit for personal, family or household purposes.

- Disclosure requirements include account-opening disclosures, change-in-terms notices, periodic statements, notice regarding treatment of outstanding credit balances, notice of credit billing errors, information regarding the calculation of the Annual Percentage Rate (APR), and notices regarding rescission rights and advertising.[46]

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44 *See* Federal Reserve System, Anti-Tying Restrictions of Section 106 of the Bank Holding Company Act Amendments of 1970 (Aug. 25, 2003).

45 12 C.F.R. § 225.7.

46 *See generally* 12 C.F.R. pt. 1026, Subpart B.

- Regulation Z imposes several residential mortgage requirements, including:
  - Ability-to-Repay (ATR) / QM Rule:[47]
    - A creditor may not make a closed-end loan secured by a dwelling unless it has made a reasonable and good faith determination at or before consummation of the loan that the borrower will have a reasonable ability to repay the loan;
    - Creditors may establish their own underwriting standards, but must, at a minimum, consider certain factors such as the borrower's income and assets, employment status, debt-to-income ratio, and credit history;
    - If a transaction satisfies the conditions for "qualified mortgage" status and the loan is not a "higher-priced mortgage loan," the creditor is deemed to be in compliance with the ATR Rule. If, however, the loan is a "higher-priced mortgage loan," there is a rebuttable presumption of compliance;
    - The QM Rule establishes certain minimum standards for a loan to be treated as a "qualified mortgage," including, for example:[48]
      - Regular, periodic, and substantially equal payments that do not result in an increased principal balance;
      - No balloon payments or prohibitions on deferral of payments;
      - A loan term that does not exceed 30 years;
      - Points and fees that do not exceed applicable limitations; and
      - The borrower's debt-to-income ratio does not exceed 43 percent.
  - Mortgage Loan Origination[49] and Mortgage Servicing Rules, which require:[50]
    - Disclosure obligations in connection with certain types of mortgages, including high-cost, reverse, and higher-priced mortgages;
    - Loan originator qualification standards and restrictions on compensation; [51] and

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[47] 12 C.F.R. § 1026.43. For further reading, *see* Arnold & Porter LLP, The Consumer Financial Protection Bureau's Ability-to-Repay and Qualified Mortgage Rule (Feb. 2013), *available at* http://www.arnoldporter.com/resources/documents/ADV213TheCFPBsAbilityToRepayAndQualifiedMortgageRule.pdf.

[48] 12 C.F.R. § 1026.43(e).

[49] For further reading, *see* Arnold & Porter LLP, CFPB Finalizes Rule on Mortgage Loan Originator Compensation and Qualifications (June 2013), *available at* http://www.arnoldporter.com/resources/documents/ADV613CFPBFinalizesRuleOnMortgageLoanOriginatorComp&Qualifications.pdf.

[50] For further reading, *see* Arnold & Porter LLP, The CFPB Finalizes New Mortgage Servicing Rules (Apr. 2013), *available at* http://www.arnoldporter.com/resources/documents/ADV413TheCfpbFinalizesNewMortgageServicingRules.pdf.

    - Independence in the appraisal process.
  - Special rules for private education loans, including:
    - Disclosures in connection with private education loans which provide information on interest rate features, fees, penalties for default or late payment, repayment terms, cost estimates, and a description of the borrower's rights and alternatives; and
    - Student lending to be limited in certain ways, including through a prohibition on a lender co-branding or co-marketing with an educational institution and by establishing the borrower's right to accept or cancel the credit arrangement.
  - Credit card rules for ability-to-pay, various fee limitations, and marketing restrictions in connection with credit card accounts, through the TILA amendments of the Credit Card Accountability and Responsibility and Disclosure Act (CARD Act).

- The Real Estate Settlement Procedures Act (RESPA) requires disclosure of real estate settlement costs. Specifically, creditors must provide certain cost statements, including a timely Loan Estimate in connection with the extension of closed-end credit.[52]

- Effective October 3, 2015, the TILA and RESPA mortgage disclosure requirements summarized above will be integrated (into the so-called TRID Rules) and creditors will be required to provide a single set of disclosures for most closed-end mortgage loans.

- RESPA also prohibits anyone from giving or accepting a kickback in exchange for the referral of real estate settlement services, which includes mortgage lending.

- The Equal Credit Opportunity Act (ECOA) requires notification disclosures to be provided to denied applicants of consumer credit. Specifically, such disclosures must be provided when a bank takes adverse action against an applicant, receives an incomplete application from an applicant, or makes a counteroffer to an applicant in connection with an application for consumer credit.[53]

Footnote continued from previous page

51 The CFPB's Mortgage Loan Originator Compensation Rule amended Regulation Z in a number of ways, including by prohibiting loan originators from being compensated based on a term of a mortgage transaction and by receiving "dual compensation," *i.e.*, payments from both the consumer and the creditor. In addition, as discussed earlier, the CFPB's ATR/QM Rule imposes limitations on the points and fees payable to a creditor or originator and RESPA, implemented by Regulation X, prohibits referral fees incident to the provision of real estate settlement services. *See* 12 C.F.R. § 1024.14(b).

52 *See generally id.* pt. 1024.

53 *See generally* 12 C.F.R. pt. 1002.

- The Gramm-Leach-Bliley Act (GLBA) is implemented in part by Regulation P and requires banks to establish policies and procedures for the collection and sharing of "nonpublic personal information," (NPI) which is generally found within customer financial records.[54] Banks, as the debt holders, must provide customers with:
  - A privacy notice describing the bank's procedures for safeguarding and disclosing NPI; and
  - An "opt out" notice allowing a customer to deny the bank the ability to share NPI with nonaffiliated third parties.

- Individual states may impose stricter disclosure obligations under their consumer credit codes and mortgage-related laws and regulations. Thus, banks may be required to comply with both federal and state disclosure requirements when extending credit to a consumer.

Fair Lending Practices

- ECOA prohibits discrimination in lending on the basis of race, color, religion, national origin, marital status, sex, age, or the applicant's receipt of public assistance.[55]

- The Fair Housing Act prohibits discrimination with respect to the "sale or rental of a dwelling"[56] on the basis of race, color, religion, national origin, sex, handicap, or familial status.

- The Home Mortgage Disclosure Act (HMDA) and Regulation C require banks to submit annual reports to their federal supervisory regulator(s) containing information regarding their mortgage lending activity. HMDA procedures include the following:[57]
  - Information is to be submitted on a Loan Application/Register (LAR), which includes data on: the number of applications received; the number of loans originated; loan type, purpose, and amount; various items of applicant information; property locations; rate information; and details on actions taken by the bank.

- The Dodd-Frank Act expanded the LAR to include data fields on age, credit score, total points and fees paid by the borrower at origination, the value of collateral, rate spreads for reported loans, and term information about specific types of loans.

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54 *See generally* 12 C.F.R. pt. 1016. Financial privacy regulation is discussed in more detail below.

55 *See* 15 U.S.C. §§ 1691 *et seq.*

56 42 U.S.C. § 3604.

57 *See generally* 12 C.F.R. pt. 1003.

- Regulators or borrowers can assert allegations of violations of fair lending laws and regulations for overt actions by lenders or under a theory of disparate treatment[58] or disparate impact.[59]

UDAAP Prohibition

- The Dodd-Frank Act established a prohibition on "unfair, deceptive, or abusive acts and practices" (collectively, UDAAP) in consumer lending, as enforced by the Consumer Financial Protection Bureau (CFPB).

- "Unfair" and "deceptive" acts and practices, as defined by the Dodd-Frank Act, closely resemble the definitions of those terms under the Federal Trade Commission Act (FTCA), which has been enforced by the Federal Trade Commission (FTC) in the commercial context for many years.
  - An "unfair" act or practice is one that causes or is likely to cause substantial injury to consumers that cannot be reasonably avoided and which is not outweighed by countervailing consumer benefits.
  - A "deceptive" act or practice is one which involves a material misrepresentation, omission, or other act that misleads or is likely to mislead the consumer and which the consumer can reasonably interpret as being deceptive.[60]

- "Abusive" acts and practices are generally new to the lexicon of federal consumer regulatory law. The CFPB has offered little guidance on the meaning of the term, but the Dodd-Frank Act limits the CFPB's ability to declare and act or practice as "abusive" to situations in which the institution:
  - Materially interferes with a consumer's ability to understand the product or service in question; or
  - Takes unreasonable advantage of the consumer's lack of understanding of the material risks, costs, or conditions of the product, the consumer's inability to protect his or her interests; or

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[58] Disparate treatment is a theory of intentional discrimination that could arise from a lender's decision not to extend credit to a loan applicant is based on the applicant's membership in a protected class of persons.

[59] Disparate impact is a theory of discrimination that could arise if a facially neutral lending practice or policy has an actually discriminatory impact on a protected class of persons, even where there is no discriminatory intent. *See Texas Dept. of Housing and Cmty. Affairs v. Inclusive Communities Project, Inc.,* No. 13-1371, 2015 WL 2473449 (S. Ct. June 25, 2015). For additional reading, *see* Arnold & Porter LLP, Don't Discount Disparate Impact After High Court Case (June 2015), *available at* http://www.arnoldporter.com/resources/documents/DontDiscountDisparateImpactAfterHighCourtCase.pdf.

[60] 12 U.S.C. § 5531(c).

the consumer's reasonable reliance on the covered person to act in the consumer's interests.[61]

Fair Credit Reporting and Debt Collection Obligations

- The Fair Credit Reporting Act (FCRA) and Regulation V govern the collection and use of consumer credit information, most notably that information found in a consumer credit report.

- Furnishers of consumer information to credit reporting agencies must develop policies and procedures that:
  - Assure the accuracy and integrity of consumer information;
  - Govern direct disputes with consumers and indirect disputes with consumer reporting agencies on behalf of a consumer;[62]
    - Dispute resolution procedures must generally include a reasonable investigation into the nature of the dispute, notification of the consumer reporting agency, and notification of the customer and an associated correction of the disputed information, if necessary; and
  - Prevent identity theft.

- Lenders that obtain consumer information from a credit reporting agency must:
  - Have a permissible purpose for obtaining the consumer report;
  - Affirm to the consumer reporting agency the intended use of the consumer report;
  - Notify consumers when adverse actions are taken;
  - Follow specific policies and procedures for dealing with fraud; and
  - Properly dispose of consumer report information when appropriate.

- The FCRA prohibits a bank from obtaining and using medical information in connection with a consumer's eligibility for an extension of credit.[63]

- The Fair Debt Collection Practices Act (FDCPA) governs the activities of "debt collectors" in attempting to collect amounts due on loans originated by banks and other creditors on behalf of those institutions.[64] The FDCPA sets forth procedural requirements (for example, limitations on the time,

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[61] *Id.* § 5531(d).

[62] 12 C.F.R. § 1022.1-.3.

[63] *See* FDIC, Compliance Examination Manual, Privacy and Consumer Information (2014).

[64] *See* 15 U.S.C. § 1692a(6).

place, and content of debt collectors' interactions with borrowers, disclosure obligations, and payment processing mandates) and prohibits certain practices (for example, specific instances of harassment and engaging in false or misleading representations or other unfair practices). Although the FDCPA technically applies only to third-party debt collectors, in practice its prohibitions can be applied to first-party debt collectors through UDAAP theories of liability, discussed above.

Community Reinvestment Act Obligations

- The Community Reinvestment Act (CRA) subjects banks to periodic evaluations to ensure that they are meeting the credit needs of the communities in which they operate, including by providing financing for affordable housing, ensuring that community services are funded, and stimulating economic development, particularly in distressed areas.[65] An otherwise satisfactory CRA rating can be reduced by findings of fair lending violations.

- A bank's CRA rating from the evaluation can have a meaningful impact on its operations and banking activities. A poor CRA rating could inhibit a bank's ability to acquire or merge into another institution or expand its banking or nonbanking activities.

Financial Privacy

- As introduced above, banks must conform to the GLBA's requirements regarding the disclosure of NPI obtained by a bank in connection with the provision of a financial product or service. NPI means "personally identifiable information" — which includes information provided to or about a customer, such as an account balance — and any list, description, other grouping of customers that is not publicly available.[66]

- Banks must conform to the initial privacy and opt-out notice requirements described above and must implement policies and procedures that conform to the GLBA's "Safeguards Rule." Under the Safeguards Rule, banks must develop a written information security plan (Security Plan). The Security Plan must:
    - Describe the bank's programs and procedures for protecting NPI;

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[65] *See* 12 U.S.C. §§ 2901 *et seq.*

[66] Note that the GLBA distinguishes between a "customer" — generally an individual with an ongoing relationship with the bank — and a "consumer" — generally an individual who has provided the bank with NPI (or NPI of the individual has otherwise been obtained by the bank), but who does not maintain an ongoing relationship with the bank. *See* 12 C.F.R. § 1016.3(e), (i).

  - Adequately identify any information security risks and impose safeguards to control such risks;
  - Include measures for employee and service provider awareness and training; and
  - Be routinely monitored, tested, and modified as needed.

- In the event of unauthorized access or acquisition of NPI, the OCC and FRB require banks under their supervision to notify their regulator, and if the circumstances require, the customer. State-chartered banks may also face notification requirements under state financial privacy and data breach notification statutes.

Conclusion

This outline presents an overview of several of the many federal and state statutes and regulations that govern the lending activities of banks in the US. This body of law, which has been complex since the early days of bank regulation in the US, has grown substantially in the aftermath of the financial crisis of the past decade. As lending activities continue to evolve through the incorporation of new technologies and a greater understanding of the shifting preferences of new generations of borrowers, expect continued change to the law and regulation governing these activities.

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