



Washington Bankers Association
2015 Regulatory Compliance Conference

Commercial Lending – Who Says It's Not Regulated?



Presented by
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Agenda

- UDAP & UDAAP
- Fair Credit Reporting Act
- ECOA/Regulation B anti-discrimination rules
- Notification of credit decision under Reg B
- Signature rules under Reg B
- Flood insurance regulations
- Reg Z coverage issues
- HMDA issues for commercial lenders



Usual Suspects

- Lending Limit (loans to one borrower)
Regulations
- Regulation O (loans to insiders)
- Real Estate Appraisal Regs
- Regulation U (loans secured by
margin stock)



Not-So-Unusual Suspects

- UDAP & UDAAP
- Fair Credit Reporting Act
- ECOA/Reg B
- Flood Insurance Regs
- Regulation Z (TILA)
- Home Mortgage Disclosure Act
- CRA
- BSA/AML
- Identity Theft & Red Flag Regs



UDAP & UDAAP Laws



Federal UDAP

- Section 5 of FTC Act – UDAP
 - **U**nfair or **D**eceptive **A**cts or **P**ractices
- Enforced by OCC, FDIC & FRB
- Applies to both business-purpose and consumer-purpose loans

Federal UDAAP

- Section 5 of FTC Act – UDAAP
 - **U**nfair, **D**eceptive or **A**busive **A**cts or **P**ractices
- Enforced by CFPB as to
 - Large depository institutions (with assets of more than \$10 billion)
 - Other entities (mortgage products, payday loans and private student loans)
 - Larger participants offering consumer financial products or services as determined by CFPB
 - Service providers to these entities



Washington UDAP Law

- Wash. Rev. Code
 - § 19.86.020 – prohibits any unfair methods of competition and unfair or deceptive acts or practices in the conduct of any business
 - § 9.04.050 – unlawful to disseminate an false, deceptive or misleading advertising



Hypothetical Example of UDAAP Case

- Business application for credit
- Loan officer quotes rate as WSJ Prime + margin of 1.50% and \$500 loan fee
- Rate set forth in note at time of loan signing is Prime + margin of 2.50%
- Is this unfair? Deceptive? Abusive?



Regulators' Expectations

- Regulators expect UDAP or UDAAP screen of all products
- Regulators emphasize UDAP & UDAAP apply to all stages of products
- Both consumer and commercial loan and deposit products



FAIR CREDIT REPORTING ACT



Fair Credit Reporting Act

- FCRA regulates use and content of consumer reports in connection with both consumer and business loans
- Credit reports on businesses and other entities are not subject to FCRA

FCRA: Using Consumer Reports on Business Loans

- Where applicant is business or other organization
- OK to obtain a principal's credit report
 - If principal “is or will be personally liable” on loan
 - Principal's consent is not required
- Example – top of page 5
- For others, you need their written consent



Using Consumer Reports (cont'd)

- Look to your institution's policy to determine who will be asked to sign guaranties
- Example – page 5
- Exercise #1 – page 5

Use of Medical Information

- Per FCRA, creditors may not consider medical information when determining whether a person qualifies for credit
- Medical Information
 - Health of any type
 - Provision of health care
 - Not age or gender *per se*



Medical Information (cont'd)

- FTC: Business credit is covered if individual is personally liable
- CFPB hasn't taken an official position on this issue

Receiving “Unsolicited” Medical Information

- Is not a violation
- If creditor did not request it and
- Creditor does not use it

Medical Info – General Exception

- General exception allows use of medical information as long as:
 - It relates to debts, income, collateral or purpose of loan
 - It's used in the same manner as comparable non-medical information and
 - You don't consider the applicant's health



Specific Exceptions

- To prevent fraud or where required by law
- To determine whether the conditions necessary to trigger a power of attorney have occurred

ECOA & REGULATION B



ECOA's General Non-Discrimination Rule

- Creditor cannot discriminate against an applicant on a “prohibited basis” in “any aspect of a credit transaction”

Prohibited Bases

ECOA Prohibited Bases	
Race	Sex
Color	Marital status
National origin	Receipt of public assistance income
Religion	Consumer's good faith exercise of consumer's rights under Consumer Credit Protection Act
Age	



General Non-discrimination Rule Coverage

- All types of credit
- All applicants, including entities
- Applies to all aspects of a credit transaction – the entire credit process

Different Types of Discrimination

- Disparate treatment
- Disparate impact

Fair Lending Examinations

- Focus is on “disparate treatment”
- Claim of discrimination based on direct or circumstantial evidence that the creditor treated applicants differently on a prohibited basis

Disparate Treatment

- Direct evidence of discrimination
 - Examples – pages 9-10
- Circumstantial evidence
 - Using loan data to identify disparities
- Treat similarly situated persons the same way
- Consistency is key!
- It's true that this is more difficult to determine in connection with business credit
- Adopt written policies and procedures and enforce adherence to them
- Track exceptions



Disparate Impact

- Facially neutral policy/practice is applied uniformly to everyone
- But policy/practice has a disproportionate adverse impact on applicants belonging to a protected group
- Disparate impact theory has been upheld in Fair Housing Act lawsuit



ECOA/Reg B Notice of Adverse Action



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Notification of Credit Decision

- “Application”
 - Oral or written request for credit made in accordance with procedures used by creditor
- Are financial statements an application?
- Do you accept oral applications?
- “Completed application”
 - Application as to which creditor has all information it generally considers in evaluating the particular type of credit requested

What is “Adverse Action”?

- Refusal to grant credit in substantially the amount or on the terms requested
 - Unless you make counteroffer and applicant expressly accepts
- Refusal to increase amount of credit available to applicant who has applied for it
- Refusal to refinance or extend term of business loan if applied for

General Notification Rule

- You're required to communicate your credit decision to the applicant
- Approvals may be communicated orally or in writing
 - For both business and consumer loan applications
 - But you must document your communication (such as sending confirming email)

General Notification Rule

(cont'd)

- If commercial loan request declined, must give adverse action notice
 - Type of notice and timing depends on applicant's revenue size (more to come)
- Withdrawn applications
 - If applicant **expressly withdraws application** before credit decision is made, no further action required
 - Document the fact that applicant withdrew the application

Small Business Credit – Notice of Adverse Action

- Small business loan applicant
 - Business with \$1 million or less gross revenues as of preceding fiscal year-end
 - Includes start-ups and single-purpose entities
- Adverse action notice can be given
 - At time of application or
 - After-the-fact, once adverse action decision is made



Notifying Small Businesses

- Option #1: At time of application – give written notice of –
 - Notice of right to a statement of reasons
 - Creditor’s contact information; and
 - ECOA notice
- Then if you decline the app, you may notify the applicant orally
 - But document oral notification



Notifying Small Businesses

(cont'd)

- Option #2: Alternatively, give notice to applicant at time of credit denial
- Notice must include either
 - The reasons for denial or
 - Statement that the applicant can request a statement of the reasons
- Exhibit B to Outline



Small Business Credit – Timing

- Completed applications
 - Give notice within 30 days of receipt of completed application
 - Notify of approval, decline or counteroffer
- Critical compliance requirement – document when application becomes complete

Timing – Incomplete Apps

- If incomplete due to something lender must obtain – use “reasonable diligence” to obtain missing information
- If incomplete as to something applicant must provide – notify applicant
- Options – send notice of incompleteness, deny application, or provide additional time to provide additional info or documentation



Timing – Counteroffers

- Make counteroffer orally or in writing
- Send AA notice if not accepted within 90 days
- Ace Widgets example – page 15
- Set reasonable time limit for acceptance
- Or send written combined counteroffer and AA notice



"Large Business" Credit

- Gross revenues of more than \$1 million
- Give oral or written notice of adverse action
- Oral notice acceptable in all cases
 - Document that you gave oral AA notice
- Notify applicant within a reasonable time
- If applicant requests, provide reasons and ECOA Notice in writing



Something We're Looking Forward To

- ECOA amended to require creditors to collect monitoring information when minority-owned, women-owned or small business applies for credit
- Similar to data collection on HMDA loans
- We're waiting for CFPB to issue a proposed rule (and we're willing to continue waiting)



Signature Rules Under Regulation B



General Signature Rule

- If applicant qualifies under creditor's standards of creditworthiness, creditor cannot require any additional signatures, unless an exception applies
- Creditors still allowed to require signatures of officers or agents who sign on behalf of business entity

Special Word re Joint Applications

- Joint applicants can be required to sign all loan docs
- Problem w/personal financial statements
 - Signatures on joint financial statement do not evidence joint application
 - Commentary requires separate “evidence of intent” to apply jointly

Joint Applications – Suggestions

- Suggestions for your PFS
 - Identify applicants and guarantors
 - “We intend to be jointly liable”
 - Signature or initial lines with date

Applications from Sole Proprietorship

- If under state law sole proprietor and sole proprietorship are one and the same, then you may require sole proprietor's signature on loan documents
- California law treats sole proprietor and sole proprietorship as the same
- Consult legal counsel re other state's laws



Sanctions Under General Signature Rule

- Regulatory violation
- Possible finding of disparate (discriminatory) treatment
- Guaranties may be unenforceable
- Actual and punitive damages
- Can lower CRA rating

Exceptions to Signature Rule

- Insider guaranties
- Secured credit
- Applicant doesn't qualify – additional support needed

Exception: Insider Guaranties

- Even though business applicant qualifies, lender may require guaranties from insiders
- “Insiders” defined by lender’s policy
 - E.g., owners of at least ____%
 - But must be non-discriminatory

Adopt a Policy re Insider Guaranties

- Define policy – just owners?
- Do you want to extend policy to officers or managers who do not have an ownership interest?
- Ties back to FCRA issue as to whose credit report you can pull
- Can't automatically apply exception to spouses of insiders
 - Example on page 19

Exception: Secured Credit

- May require signatures of co-owners (even a spouse/co-owner) necessary to make collateral available upon default
- Can't require co-owner to become personally liable
 - That is, you can't require co-owner to sign note or guaranty

Additional Support Needed

- You may require a cosigner or guarantor when an applicant just doesn't qualify
- Creditor may adopt non-discriminatory guidelines for guarantors
- Renewals – be careful

FLOOD INSURANCE REGULATIONS



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Flood Insurance Regs

- Business, commercial & consumer loans covered
 - Purchase, refis, equity, construction, etc., regardless of lien position
- Secured by improved real property or mobilehome
 - Walled & roofed structure
 - Includes buildings in the course of construction



Flood Regulations – Coverage

- No exception for collateral taken as abundance of caution
- Flood insurance, if required, can **NEVER** be waived by the lender



Lender's Duties

- Perform flood zone determination
 - Most lenders outsource this function
- Use SFHD form to document
- 4 triggering events
 - **M**ake, **I**ncrease, **R**enew or **E**xtend (**MIRE**) a loan
- Special flood hazard area
 - “A” zones & “V” zones



Flood Insurance Required

- If property is in a special flood hazard area – A zone or V zone, and
- Community “participates” in NFIP
- Then lender must ensure borrower has purchased flood insurance policy before loan closes

Notice to Borrower

- Give notice when property is in SFHA
- Notice must advise whether or not flood insurance is required
 - That is, whether or not community participates in NFIP
- Give notice within a reasonable time prior to closing
 - 10 days is considered reasonable
- Need evidence of insurance before loan closes



Amount of Required Flood Insurance

- Lesser of 3 amounts
 - Loan amount or credit limit
 - NFIP maximum for property type
 - Replacement cost value of improvements
- Flood insurance also required for personal property collateral located in building
 - Be careful re terms of deed of trust
- Junior-lien loans – combine loan amounts



NFIP Coverage Limits

Building Coverage	Regular Program
Single-family dwelling	\$250,000
2-4 family dwelling	\$250,000
Other residential	\$500,000
Nonresidential	\$500,000
Condominium master policies	\$250,000 x number of units
Contents Coverage	Contents Coverage
Residential	\$100,000
Nonresidential	\$500,000



Example – page 23

Loan amount	\$2,000,000
Total appraised value of real property	\$2,950,000
Value of land	\$1,100,000
Value of improvements	\$1,850,000
Value of inventory (high average)	\$ 340,000
NFIP Limit – Building	\$ 500,000
NFIP Limit – Contents	\$ 500,000
Required insurance – Building	\$ 500,000
Required insurance – Contents	\$ 340,000



REGULATION Z COVERAGE RULES



Coverage of Regulation Z

- Are business loans ever covered by Regulation Z? Well,
- Consumer-purpose credit
 - Extended to consumers (natural persons)
 - For personal, family or household purposes (“consumer-purpose”)

Regulation Z Exemptions – Overview

- Loans to organizations
- Business-purpose credit
 - Special rules re:
 - Investment loans
 - Rental property loans
- Some types of credit “over \$54,600” depending upon collateral

Organizational Credit Exemption

- Loans to organizations – Exempt. Period.
- Sole proprietors – if sole proprietorship is not an “organization” under state law, you must establish business purpose
- Consumer loans to family trusts – covered as of October 3, 2015



Business-purpose Credit Exemption

- Loans primarily for business, commercial or agricultural purpose
- Examples – pages 24-25
- Mixed-purpose loans
 - Primary purpose controls

Investment Loans to Individuals

- Are they exempt as business loans? Not necessarily
- “Five factor” test – document your analysis
 - **Is borrower’s occupation related to investment?**
 - **To what extent is borrower involved in managing investment?**
 - **What is the ratio of income from investment vs. borrower’s total income?**
 - Size of loan
 - Borrower’s stated purpose



Special Rental Property Rules

- Special rules apply to loans to individuals secured by rental property
- Two sets of rules – one for owner-occupied property and the other for non-owner occupied rental property
- “Non-owner occupied”
 - Applicant does not intend to occupy residence for more than 14 days in coming year

Non-owner Occupied Rental Property

- Loan to acquire, improve, or maintain non-owner occupied rental property is automatically exempt
- Regardless of # of units
- Don't have to analyze under five factors
- Caution re refinancings



Owner-occupied Rental Property

- Property considered owner-occupied if borrower intends to occupy residence more than 14 days in coming year
- Loan to acquire more than 2 units is exempt
- Loan to improve or maintain more than 4 units is exempt



Reg Z Special Rental Property Rules

Regulation Z Special Rental Property Rules				
Occupancy Status	Purpose			
	Acquire		Improve/Maintain	
Owner occupied	1 to 2 units not exempt	3 units + Exempt	1 to 4 units not exempt	5 units + Exempt
Non-owner occupied*	Exempt (regardless of the number of units)			

* “Non-owner occupied” means the borrower does not intend to occupy the rental property for more than 14 days in the coming year



HMDA & REGULATION C



HMDA & Regulation C

- Is your institution subject to HMDA?
- Depends on institution's asset size as of prior 12/31, location of its offices and whether it made a "triggering loan" in prior calendar year
- Ask your compliance officer, CRA officer or risk officer if you don't know the answer



Triggering Loan

- If institution meets asset-size threshold and has an office in an MSA, then HMDA coverage triggered if institution made a “triggering loan” in preceding calendar year
 - Home purchase loan secured by a first lien on a 1-4 family dwelling
 - Refinancing of a home purchase loan in which both loans are secured by a first lien on 1-4 family dwellings

HMDA & Regulation C

- Emphasize to commercial lenders that if the bank is subject to HMDA, they have to report all HMDA-covered loans (regardless of the number of units in the dwelling)
- Home purchase loans
- Home improvement loans
- Refinancings



Refinancings under HMDA

- Refinancings – new obligation satisfies and replaces an existing loan by the same borrower, in which both the existing loan and the new loan are secured by liens on a dwelling
- Includes satisfying existing business-purpose loan
- Example – page 29



Conclusion

- Questions – time permitting

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