Headache vs. Hassle-Free:
How Technology Can Ease the Burden of Regulatory Compliance

An Equifax White Paper
Andrew Skillen
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Introduction

Lenders have long been on the receiving side of rigorous oversight and scrutiny from legislators and regulators. The last 10 years in particular have resulted in an unprecedented number of additional mandates requiring banks and other financial institutions to commit an ever-growing amount of resources to regulatory compliance.

Banks are spending $330 billion on risk management and compliance, of which almost 80 percent is administrative expense.\(^1\) It is common to hear lenders say they are spending two to three times as much on compliance as they were a few years ago, and that the cost is growing at a rate that is unsustainable — especially for community banks.

According to an *American Banker* poll, the implementation of the Financial Services Regulatory Relief Act in 2006 did little to relieve the sense of regulatory burden felt by lenders. Rather, the impression is that the burden is increasing, especially as concerns related to mortgage lending grow.\(^2\) In the same poll, lenders reported worries that legislators would tighten oversight of mortgage lending and push for even greater regulation in the future. The threat of new laws only adds to the already frustrating level of compliance burden faced by lenders.

This white paper will review some of the key pain points associated with selected regulations, and explore how technology can help to lessen this burden. Added emphasis is placed on the newer regulations.

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\(^1\) Bank Systems & Technology, TowerGroup - Feb. 2007  
\(^2\) American Banker, September 14, 2007
Regulatory Pain Points - Consumer Lending

The Community Reinvestment Act (CRA)
Enacted by Congress in 1977, the CRA is intended to encourage depository institutions to meet the credit needs of the communities in which they operate, including low- to moderate-income neighborhoods. While CRA requires compliance throughout the entire institution, affordable housing and community development loans are primary indicators of an institution’s contribution to CRA initiatives.

A 2002 ICBA/Grant Thornton study entitled “The High Cost of Community Bank CRA Compliance: Comparison of ‘Large’ and ‘Small’ Community Banks” revealed that CRA compliance costs can more than double when community banks grow beyond $250 million in assets and are no longer subject to streamlined examinations.

The Fair Credit Reporting Act (FCRA)
The FCRA requires lenders to perform certain activities as they relate to consumers, such as:

- Exercise due diligence in verifying the identity of a consumer applying for credit when the credit report includes an initial or extended fraud alert or an active military duty alert;
- Upon receipt of a notice of address discrepancy, verify the address of the consumer when issuing a limit increase or new credit card;
- Provide various notices within specific timeframes, such as a Notice to Home Loan Application disclosure, a Risk Based Pricing Notice, and a notice of adverse action on credit applications.

Identity Theft Red Flags and Address Discrepancies
In October of 2007, the final regulations implementing Section 615(e) Red Flag Guidelines of the FCRA were published. These guidelines require financial institutions or creditors covered by this regulation to implement a written Identity Theft Program designed to detect, prevent and mitigate identity theft. Lenders must reasonably safeguard against known identity theft patterns and practices, and assess the validity of change-of-address requests and address discrepancies related to requests for consumer reports or
credit/debit cards. The Red Flag rules go into effect starting on October 1, 2008. The four key areas for compliance with the new program are:

- Identify relevant red flags for covered accounts and incorporate those red flags into the program;
- Detect red flags that have been incorporated into the program;
- Respond appropriately to any red flags that are detected to prevent and mitigate ID theft;
- Periodically update the program to reflect changes in risks to customers or to the safety and soundness of the institution from ID theft.

**Regulation B - Equal Credit Opportunity Act (ECOA)**

Regulation B requires lenders to notify applicants of the action taken on their application within 30 days. Under the Board of Governors of the Federal Reserve System’s November 2007 revision to the ECOA, creditors may provide certain disclosures required in Regulation B in electronic form without obtaining the consumer’s consent pursuant to the ESIGN Act. The Board revised the commentary to Regulation B to reflect, as an example, that where a consumer accesses and submits an application form using a home computer via the lender’s Web site, the creditor must provide the disclosures electronically with the application form on the Web site to provide disclosures in a timely manner on or with the application.

**PAIN POINT**

Lenders doing business online with consumers who aren’t physically present must provide electronic disclosure in a timely manner on or with the application. This puts pressure on lenders to automate the determination and delivery of all appropriate disclosures in near real-time.

**Homeownership and Equity Protection Act (HOEPA)**

HOEPA attempts to minimize predatory lending practices by prohibiting certain loan terms and requiring that additional disclosures and information be relayed to the borrower prior to signing. The HOEPA APR rule requires lenders to track their APR against the yield on comparable Treasury securities and make disclosures to borrowers when first- or second-lien loans exceed certain limits.

**PAIN POINT**

Lenders must be able to track their APR against the yield of Treasury securities to determine if certain loans exceed HOEPA thresholds. Manually tracking constantly changing yield rates, loan terms and spreads is labor intensive.
Home Mortgage Disclosure Act (HMDA)

HMDA requires lenders to collect information on mortgage applications and disclose, on an annual basis, the distribution of mortgages and home improvement loans in a community. Lenders spend a significant amount of time each year preparing their HMDA Loan Application Register, as inaccuracies can result in serious disciplinary actions including significant fines. Lenders must track and report for some loans the spread between the APR and the yield on Treasury securities. The HMDA rate spread calculation uses different rates and dates than used in the HOEPA rate spread mentioned above. This regulation also requires lenders to report declined loans along with the reasons, using a list of reasons provided in the regulation.

USA PATRIOT Act

The USA PATRIOT Act affects lending institutions by requiring them to check loan applicants against the government’s Office of Foreign Asset Control (OFAC) list. The USA PATRIOT Act also requires lenders to record specific identification information on applications such as passports, military IDs and driver’s licenses.

Regulatory Pain Points - Authentication

Multi-Factor Authentication

The Federal Financial Institutions Examination Council (FFIEC) issued guidance entitled “Authentication in an Electronic Banking Environment” that requires lenders to establish plans which go beyond single-factor authentication (for example, the use of only a logon ID/password). Lenders offering electronic banking services were advised to implement multi-factor authentication by the end of 2006. Customer identity verification during online origination is also required by section 326 of the USA PATRIOT Act.
How Technology Can Help

In spite of all the grumbling, lenders agree that many of the regulations on the books today are important and needed to protect consumers and to keep the financial system solvent. However, as banking and finance activities have become more complex, so have the regulations.

Technology is the clear solution to managing processes that could once be handled manually. Certainly technology is preferable to manual methods and is critical to collecting clean data for accurate reporting. The right technology solution can play an important role in helping financial institutions comply with consumer lending regulations while increasing efficiency and reducing costs associated with compliance. Deploying new technology is about more than just getting help with the numerous data capturing, tracking, and reporting tasks associated with compliance.
Lending institutions must view compliance initiatives more strategically and look for technology-based solutions that:

- Automate compliance around the most burdensome regulations;
- Minimize the chance for compliance errors;
- Fill in knowledge gaps for less experienced personnel;
- Create a foundation for complying with future regulatory requirements.

The Right Solution: Be Compliant from the Beginning

With a wide range of options to choose from, it can be difficult to determine which technology solution will actually fulfill the promise of reducing regulatory and compliance burden. One thing is for sure - the loan origination and application processes are the key starting point for being compliant down the line. For financial institutions involved with consumer lending, keeping specific needs in mind when evaluating technology solutions for these key initiators will make the downstream job of remaining compliant much easier.

Here are four things to look for when evaluating technology solutions that will lead to a significant reduction in the consumer-lending compliance burden.

1. Streamline the compliance process

One way to cut expenses is to look for systems that streamline existing processes and ensure that the lending institution is not duplicating efforts and spending needless time and money on compliance.

Many of the data requirements associated with consumer-lending regulations are inherent in the loan origination and application process, so a good solution will combine loan application processing with compliance monitoring. Look for solutions that:

- Capture data that determine which loans contribute to CRA initiatives;
- Allow for enabling or disabling of CRA monitoring at the product level (for institutions not required to comply with CRA);
- Have fields for data required by HMDA to determine if a loan is reportable under HMDA;
• Provide required fields for recording specific information required by the USA PATRIOT Act such as ID numbers, issuance data, and expiration date on identification documents;

• Allow applicants to opt out from having their information shared with a non-affiliate or an affiliate as required by the FCRA.

2. **Built-in “Knowledge”**

With the unwieldy number of regulations, it is nearly impossible for a loan or compliance officer to remember and track all the rules for every application. Look for the right technology solution to “know” and comply with the rules around the following regulations:

**Home Mortgage Disclosure Act (HMDA)**

• Determines if a loan is reportable under HMDA using the spread to yield on Treasury rules

• Allows users to manually flag a loan as HMDA reportable

• Automates the tracking of “decline reasons” as specified by HMDA

• Gives users the ability to entry Treasury rates to determine HMDA rate spread

**Home Ownership and Equity Protection Act (HOEPA)**

• Automatically determines if a new loan is HOEPA reportable

• Notifies loan processor and enables HOEPA page and forms related to the transaction

• Automatically performs a HOEPA determination when the loan purpose is not a home purchase and the credit product is secured by residential real estate that is owner occupied

• Analyzes and compares fees and loan terms entered against Treasury rates

**USA PATRIOT Act**

• Allows users to perform a real-time OFAC lookup and view OFAC alerts when requesting a credit report

• Prevents an auto-decision from occurring when a positive OFAC match is returned, and provides or even assigns resources for a manual review process

• Uses multiple data sources to verify and authenticate a consumer’s identity prior to originating accounts
Multi-factor Authentication and Red Flag Guidelines

- Allows for asking “shared secret” questions, or prompts online consumers with out-of-wallet authentication questions that only the actual consumer would know
- Automates and tracks the assignment of Red Flag codes to activities flagged as suspicious
- Adds another factor of authentication with minimal disruption to existing processes

3. Automatic Reports and Documents

In an effort to protect borrowers, many consumer-lending regulations require disclosures to loan applicants, as well as tracking and reporting those disclosures to the government. A good technology solution will automatically generate all reports, disclosures and letters to help lenders stay on track. Look for a solution that:

- Generates the annual HMDA Loan Application Register by uploading data directly from applications;
- Maintains “Notice to Home Loan Applicant” and “Risk Based Pricing Notice” language to print on disclosures, and automatically reports these notices;
- Generates Disclosure letters and Adverse Action letters for applicants that have a status of decline or counteroffer as required by FCRA and Regulation B;
- Provides Compliance Day Management, making it easier to track and notify applicants of action taken on their application within the required 30-day period as required by Regulation B.

4. Significant Compliance Issues Solved

Compliance with all regulatory requirements, including those not mentioned herein, is necessary. Because the penalties for non-compliance can be stiff, including legal or regulatory sanctions, fines, financial loss, and damage to reputation and brand, finding a technology solution that addresses the most significant and burdensome compliance issues is critical. Eliminating redundancies, having access to essential information, and meeting the expectations of regulators can help reduce the burden.

- Both HMDA and HOEPA require lenders to disclose to borrowers and the government when loans have a certain spread between the APR and the applicable Treasury yield. Having a built-in Treasury Rate Maintenance program is a critical feature for lenders in determining which loans are reportable under HMDA or HOEPA.
• The FCRA and the USA PATRIOT Act both require lenders to verify addresses and identities of borrowers. In addition, lenders must be able to access various databases in order to receive fraud alerts, active duty alerts, address discrepancy notices, and OFAC Alerts, so they can flag applications and comply with regulations.

• During exams and audits, regulators want to see proof of compliance, which often means showing documents and any associated documents and “actions.” A good solution allows users to view the history of all documents generated including disclosures, notifications, and other supporting documentation.

To Compliance and Beyond

While the basic goal of regulatory compliance is simply to “comply,” lending institutions that do their homework and find an effective compliance management tool will do more than simply reduce their regulatory burden with the right technology solution. Lenders can leverage investments in compliance technology to support business strategies such as expanding loan product offerings.

Having the right technology partner is as important as finding the right technology solution. Equifax is one of the lending industry’s leading providers of comprehensive, automated credit risk management and financial technologies for online and traditional lending environments.

Equifax’s APPRO loan origination system is a comprehensive lending solution that not only meets your loan processing needs, but helps reduce the burden of regulatory compliance associated with CRA, FCRA, HMDA, HOEPA, and USA PATRIOT Act regulations. Equifax’s eID solution for authentication helps add an additional factor of authentication for compliance with FFIEC multi-factor authentication and Red Flag regulations. Equifax offers robust solutions to help you Know Your Customer.

Equifax’s eID solution offers identity verification and authentication. When used in conjunction with a traditional ID/Password mechanism, eID provides an additional factor of authentication in a knowledge-based multi-factor solution. eID can be used to initially authenticate an individual for the purpose of issuing an authentication token (e.g., digital certificate, random number generator key fob, etc.) for later authentication usage.
eID can also be used to generate a personal, multiple-choice Knowledge-Based Authentication (KBA) question which can be delivered via other methods, such as text message or email, to authenticate individuals using alternate channels of communication.

APPRO and eID seamlessly integrate to offer lenders a robust regulatory compliance solution for both lending and authentication.

For more information on how Equifax can help your lending institution reduce compliance costs, please visit www.Equifax.com or call 1.888.987.1687 - ext. 5.

**About the Author**

Andrew Skillen, a director of marketing at Equifax, has more than 18 years of experience in sales and marketing of business and consumer products for such companies as Adobe, Macromedia, Dole and Del Monte. Mr. Skillen is currently responsible for the marketing of Technology Services at Equifax. He has a B.A. degree in Computer Science and Economics, a Masters in International Management from Thunderbird School of Global Management, and an M.B.A. from ESADE, Barcelona.