



FEDERAL RESERVE BANK OF PHILADELPHIA

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## Compliance Implications of Electronic Delivery Systems: Guidance is Coming

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On February 13, 2000, the Federal Reserve System released draft guidance for examiner use in reviewing a bank's electronic delivery systems. In addition to the written examination guidance, the System developed a training web site to aid examiners in assessing a bank's website for compliance with consumer protection laws and regulations. Federal Reserve examiners are now using the new procedures and the training web site. The draft guidance and the training web site, which are for internal Federal Reserve System use only, will be revised and issued in final form later this year. The final procedures and the web site will eventually be available to the public.

### Written Examination Guidance

The written examination guidance serves as a tool to ensure that examiners consider compliance issues in an electronic environment. The draft guidance is divided into four functional examination areas—Advertising, Lending, Deposits, and Stored Value Products. The guidance addresses applicable laws and regulations affecting each of the four functional areas, providing general information and specific examination objectives for each law.

The overall examination objective is to ensure that the consumer protections currently provided under the regulations for paper-based delivery systems are also applied to transactions occurring through electronic delivery systems. Many of the general principles, requirements, and controls within the current consumer protection regulatory environment apply to financial services conducted electronically.

Many requirements  
in the current  
regulatory environment  
apply to electronic  
delivery systems.

**Advertising.** The federal banking regulators consider a bank's website to be an advertisement. This means that a bank website is subject to the advertising provisions in laws and regulations such as the Fair Housing Act, Truth in Savings (Regulation DD), Truth in Lending (Regulation Z), Consumer Leasing (Regulation M), and the Equal Credit Opportunity Act (Regulation B), among others. Examples of the advertising provisions in these existing regulations that also apply to websites appears in the box on page 2.

The same analysis can be applied to two other functional examination areas—Lending and Deposits.

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**Lending.** Institutions that solicit loan applications

or provide lending disclosures over the Internet or through another electronic delivery system must ensure that the activities conducted are consistent with the regulations. Where a regulation expressly authorizes electronic communication, institutions may comply with the regulation via electronic communication of disclosures. Absent express authority, however, regulatory compliance should be accomplished through traditional, paper-based methods.

Seven consumer laws and regulations address lending and leasing activities by banks:

- Consumer Leasing (Regulation M)
- Truth in Lending (Regulation Z)
- Real Estate Settlement Procedures Act (RESPA) (Regulation X)
- Equal Credit Opportunity Act (Regulation B)
- Home Mortgage Disclosure Act (Regulation C)
- Fair Credit Reporting Act
- Flood Insurance (Regulation H)

**Deposits.** Institutions that solicit deposits or provide deposit-related disclosures over the Internet must do so consistent with existing regulations. Four consumer laws and regulations address the deposit functions:

- Truth in Savings (Regulation DD)
- Availability of Funds and Collection of Checks (Regulation CC)
- Reserve Requirements of Depository Institutions (Regulation D)
- Electronic Fund Transfers (Regulation E)

**Stored Value Products.** Electronic stored value products go by many names, including stored value cards, smart cards, and electronic cash. Currently, there are no consumer protection laws or regulations that specifically address electronic stored value products; therefore, there are no specific examination guidelines for stored value products. However, to the extent that a stored value product is also a credit card or a debit card, then the appropriate lending or deposit regulations would apply.

### **What will the examiners review to determine compliance?**

The examiners' review of electronic delivery systems will encompass those areas that pose the greatest

## **Advertising Regulations and Electronic Delivery Systems**

### **Fair Housing Act**

- Equal Housing Lender logotype, slogan, or statement is properly displayed on web pages that promote loans to purchase, construct, improve, or repair a dwelling
- No advertisement expresses, implies, or suggests a discriminatory preference or policy by words, symbols, or models

### **Truth in Savings (Reg. DD)**

- Advertisements contain all of the prescribed information (§230.8)

### **Truth in Lending (Reg. Z)**

- Advertisements state available terms and express loan rates properly (§226.16 and §226.24)
- Additional credit terms are disclosed when triggering terms are advertised (§226.16(b))

### **Consumer Leasing (Reg. M)**

- Advertisements contain all of the required disclosures (§213.7)
- Additional credit terms are disclosed when triggering terms are advertised (§213.7(d))

### **Equal Credit Opportunity Act (Reg. B)**

- No advertisement expresses, implies, or suggests a discriminatory preference or policy of exclusion by words, symbols, or models (§202.5(a))

risk to the bank and its customers. Examiners will assess the compliance management processes that are designed to identify, monitor, and manage these risks. In so doing, examiners will evaluate the degree of board and management oversight. The institution's board and management

should recognize the consequences associated with noncompliance, and devote sufficient resources to ensure that the compliance program covers electronic banking systems. Management is also responsible for instilling a compliance culture throughout the organization, including the administration of electronic banking systems.

Examiners will also determine the compliance officer's involvement in the development, implementation, and review of disclosures for the bank's electronic delivery systems. The compliance officer's participation in all aspects of website development is critical to ensure compliance with the myriad of laws and regulations.

Finally, examiners will assess the institution's policies, procedures, training, audits, and internal controls to ensure compliance with all the provisions of the regulations in an electronic environment.

Examiners will base the scope of their review on the degree of complexity of the institution's electronic delivery systems and the effectiveness of the compliance management program. For example, a complex website in a large bank with inadequate management oversight will require a broad examination scope. On the other hand, an examiner may determine that a less complex website at a small bank with adequate management controls will require less regulatory review.

### Training Web Site (The Checkers Bank)

The second section of the draft guidance consists of a training web site. The Checkers Bank is an online, simulated bank with a variety of compliance violations. The content on The Checkers Bank web pages simulates

The screenshot shows the website for 'The Checkers Bank'. The header includes the bank's logo (TCB) and the title 'Checking Accounts'. A navigation menu on the left lists: Special!, Products, Virtual Village, Employment, About Us, TCB Home, and Site Intro. The main content area features three account types, each with a list of features:

- Free Checking**
  - Open with a deposit of \$10.00
  - First order of personalized checks at no cost
  - ATM card at no cost
  - Checks are held in safe keeping and available at no cost for 90 days (\$1.00 per item retrieval charge after 90 days)
- NOW Account**
  - Earn interest when your balance exceeds \$500.00
  - Earnings tied to U. S. Treasury securities
  - Interest is compounded monthly and paid monthly
  - Open with a deposit of \$100.00
  - First order of personalized checks at no cost
  - ATM card at no cost
  - Checks are held in safe keeping and available at no cost for 90 days (\$1.00 per item retrieval charge after 90 days)
- Super NOW Account**
  - Earn interest when your balance exceeds \$2,500.00
  - Earnings tied to U. S. Treasury securities
  - Interest is compounded monthly and paid monthly
  - Open with a deposit of \$1,000.00
  - Personalized checks at no cost
  - ATM card at no cost
  - Checks are held in safe keeping and available at no cost

At the bottom of the account list are links for [Rates](#) and [Terms & conditions](#).

### Compliance Violations at The Checkers Bank

**Violation:** This page promotes deposit products, but lacks the official FDIC membership statement (Part 328).

**Corrective action:** Add membership statement to all pages that promote deposit accounts.

The term "free" is used to describe a checking account that requires \$1.00 per item retrieval charge.

**Corrective action:** Discontinue use of the term "free," or eliminate fee.

data that examiners will encounter during an examination, and provides tutorial guidance assisting the examiners with their review.

The Checkers Bank is currently not available to the public. However, the Federal Reserve System plans to make this website publicly available in the near future. Above is an illustrative screen from The Checkers Bank,

which may contain violations of existing regulations. Test your compliance knowledge and see if you can find the violations.

### **Conclusion**

The rapid pace of change in electronic banking presents potential risks to banks and consumers alike. Therefore, it is important that senior bank management and compliance professionals implement effective internal policies and compliance risk management procedures for the electronic delivery of deposits and loans. Although legislators and bank supervisors wrote the current regu-

lations for a paper-based banking system, they still apply in the electronic world. Consequently, although the draft procedures have not been released publicly, I encourage you to carefully review your institution's website to ensure that it complies with both the letter and the spirit of the existing laws and regulations.

If you have any questions regarding compliance and electronic banking, please contact Connie Wallgren, Consumer Compliance Examinations Manager at (215) 574-6217 or Supervising Examiner Eddie L. Valentine at (215) 574-3436.