FEDERAL RESERVE BANK OF PHILADELPHIA

SRC INSIGHTS

A newsletter published by the Supervision, Regulation & Credit Department for the institutions that it supervises.

Volume 5, Issue 3 First Quarter 2001

IN THIS ISSUE

Please Route To:

☐ ____________________

☐ ____________________

☐ ____________________

☐ ____________________

SVP Commentary on...

Career Development

by Michael E. Collins

Today's environment demands that organizations transform themselves continuously. In fact, I have frequently commented on the myriad of effects that the rapid pace of global change has on the financial services industry. In previous columns I discussed the impact of change on mergers and acquisitions, credit underwriting, technology, and corporate governance. Now, I would like to address the impact of change on an area that is easily and frequently overlooked – career development and continuing professional development.

The growing emphasis on speed means that continuous improvement and innovation have to become priorities for organizations. Although technology advances still occur at a rapid pace, those very advances have ensured that all organizations, whether large or small, can assimilate new technologies as they are developed. Consequently, what differentiates one organization from another is not its adoption rate of new technologies, but is the skills, commitment, and talent of its staff. Through an investment in human capital, organizations can combine today's need for performance with tomorrow's imperative for transformation.

One theme that I have heard in my discussions and meetings with bankers is the increasing difficulty in hiring and retaining qualified staff. The length of the current economic expansion has taken us to new levels of employment and has led to increased turnover as staff are enticed to new employers with promises of signing bonuses and significant raises. Not every organization can or wants to compete for staff with dollars. However, a work atmosphere that is intellectually, emotionally, and professionally satisfying, coupled with career development challenges and opportunities to advance, could lure top performers and improve staff retention. Many organizations have implemented career development programs for this purpose.

Career development is much more than training. When properly structured, career development links an individual's career needs with the

continued on page 6

Sign Here, Please!

by Carletta M. Longo, Examiner, and John D. Fields, Supervising Examiner

Signature requirements (12 CFR 202.7) are one of the more complex and often misunderstood provisions of Regulation B, the *Equal Credit Opportunity Act.* These requirements were originally designed to ensure that qualified applicants, specifically married women, would be able to obtain credit in their own names. However, the scope of the requirements extends to applicants of both genders. This article should help to dispel confusion about the application of these requirements under a variety of conditions.

Historical Perspective

Congress enacted the *Equal Credit Opportunity Act*, which the Federal Reserve implemented in Regulation B, to ensure that financial institutions engaged in the granting of credit exercised their responsibility to make credit available with fairness and impartiality and without discrimination on the basis of sex or marital status. Congress believed that economic stabilization would be enhanced and competition among financial institutions and firms engaged in lending would be strengthened by the absence of discrimination on the basis of sex or marital status, as well as by the informed use of credit, which Congress sought to promote.

The regulation prohibits discrimination in any aspect of a consumer or business credit transaction on the basis of race, color, religion, national origin, sex, marital status, or age (provided the applicant has the ability to enter into a contract); receipt of public assistance; or the fact that the applicant has exercised any right under the *Consumer Credit Protection Act.* All individuals and institutions that regularly participate in decisions to grant credit must comply with Regulation B.

Signature Requirement Rules

Among the key sections of Regulation B relating to discrimination based on sex and marital status are those regarding the signatures that a creditor may require when granting a loan. The purpose of these sections is to permit people, particularly women, who are creditworthy in their own right to obtain credit on their own by removing, to the greatest extent possible, the need to depend on a spouse or any other person.

Two general rules apply to the signature requirements of the regulation:

- A creditor may not require a signature other than the applicant's or joint-applicant's if, under the creditor's underwriting standards, the applicant qualifies for the credit requested.
- A creditor may require signatures on documents that are used as security for a loan or which support the customer's creditworthiness, but the creditor's ability to obtain signatures other than the applicant's to establish a contractual obligation to repay the debt is limited.

The second point establishes the distinction between a debt instrument and a security instrument. A debt instrument, such as a loan note, promissory note, or contract (collectively referred to as a "note"), is legal evidence of a debt and generally contains a promise to repay. The signer of a note accepts the obligation to repay the debt. A security instrument, such as a mortgage, deed of trust, indenture, or other security document, creates a limited obligation, which allows the creditor access to the signer's interest in the property in the event of default. This article will discuss both points in detail.

Qualified Applicant

The first rule prohibits a creditor from requiring a signature other than the applicant's or joint applicant's if the applicant is qualified (creditworthy) based on the creditor's underwriting standards for the loan requested. A creditor may not routinely require the applicant's spouse to sign any document that establishes a contractual obligation to repay the loan.

If an applicant does not qualify for a loan based on a creditor's underwriting standards, the creditor may require a creditworthy co-signer, but the creditor may not require that person to be the applicant's spouse.

Jointly Owned Property

The second rule permits creditors to require signatures on documents that are used as security for a loan or which support the customer's creditworthiness. For example, if a loan is to be secured by real estate, a creditor may require any person who owns an interest in the property, including the spouse, to sign any document the creditor reasonably believes to be necessary under state law to make the property available to satisfy the debt in the event of default. However, the creditor may not require a co-owner to sign the note, which creates a contractual obligation to repay.

Thus, a creditor has more latitude in requiring signatures on documents that are necessary to perfect its security interest in the property or that support the borrower's creditworthiness than it has in obtaining co-signatures on documents that establish the contractual obligation to repay. For example, if real property is used to secure a loan, a creditor may require any and all owners of the property, including the spouse, to sign a security instrument; this action does not violate the regulation. If personal property such as an automobile or a certificate of deposit is used to secure a loan, a creditor may require any and all co-owners to sign a security agreement, hypothecation, or a pledge of their interest in the property without violating the regulation. However, co-owners may not be required to sign the note, which contractually obligates them to repay the loan in the event of default.

> A creditor has more latitude in requiring signatures on documents that are necessary to perfect its security interest.

In addition to the signature requirements, if an applicant relies on joint property to establish creditworthiness, the creditor must separately value the applicant's interest in any jointly owned property. To accomplish this, a creditor may request that an applicant provide a listing of assets and income jointly and individually owned, allowing the creditor to evaluate the applicant's creditworthiness on an individual basis.

If the applicant's interest in jointly owned property does not support the credit requested, a creditor may require the other joint owners to sign a document creating a security interest in the property. For example, a creditor might receive a loan request for $100,000, with jointly owned real estate valued at $100,000 pledged as security. Assuming equal ownership, the creditor may not require the joint owner to sign any document other than that which creates the security interest.

To determine the value of an applicant's interest in jointly owned property, a creditor may consider factors such as the form of ownership and the property's susceptibility to attachment, execution, severance, or partition; the value of the applicant's interest after such action; and the cost associated with the action. This determination must be based on the form of ownership prior to or at consummation and not on the possibility of a subsequent change. For example, when a married applicant applies for individual credit and qualifies based on individually owned property, a creditor may not consider the possibility that the separate property might later be transferred into joint ownership. Similarly, in valuing a married applicant's interest in property, a creditor may not consider the possibility that the couple might divorce. A creditor may not require the signature of the nonapplicant spouse in the above or similar circumstances.

This article does not address community property rights, since it is directed to State Member Banks in the Third Federal Reserve District. None of the states comprising the Third District—Pennsylvania, New Jersey, and Delaware—are community property states. Banks lending in community property states should consider the effect of state law on their lending policies and practices.

Guarantors

A guarantee of a credit extension is part of a credit transaction and is covered by the regulation, including the signature rules that prohibit a creditor from requiring the signature of a guarantor's spouse. The creditor may require the personal guarantee of the partners, directors, or officers of a business and the shareholders of a closely held corporation, even if the business or corporation is

continued on page 5

Interagency Information Sharing on Insurance Activities: Relying on Functional Regulators

by Tom Pulkkinen, Sr. Financial Services Markets Specialist,
Knowledge Center for Insurance Activities, Federal Reserve Bank of Boston

Bank holding company (BHC) inspections focus significantly on measuring risks and risk management systems. When BHCs own insurance subsidiaries or are themselves insurance companies, the consolidated risk assessment must consider the composition, materiality, and management of insurance company related risks. The Gramm-Leach-Bliley Act (GLBA) provides guidance on how the Federal Reserve should consider the risks of insurance activities.

Section 111 of GLBA provides that in fulfilling its supervisory responsibilities, the Federal Reserve will initially rely upon public information, external audit reports and information provided by the BHC to other regulators and self-regulatory organizations. Any additional information deemed necessary is to be acquired through the functional regulator and, only as the last option, from the functionally regulated entity. Section 307 of GLBA instructs the Federal Reserve and state departments of insurance (DOIs) to coordinate their supervision of companies that control both a depository institution and an insurance company.

> The Federal Reserve must rely upon functional regulators when it assesses the risks present in BHC insurance activities.

The Federal Reserve must rely upon the supervisory efforts of functional regulators when it assesses the risks present in BHC insurance activities. The Federal Reserve may conduct on-site supervisory activities only when:

- A functionally regulated entity poses material risk to an affiliated bank,
- A review is necessary to assess the risk management system, or
- Indications exist that the affiliate may not be complying with laws or rules for which the Federal Reserve has enforcement authority.

Opportunities may develop in the future for coordinated Federal Reserve-DOI reviews under these situations and for cross-regulator program development and educational purposes.

Insurance regulators are committed to responding to the Federal Reserve's information needs and meeting the many regulatory challenges emanating from GLBA. Accordingly, to facilitate the information gathering process prescribed by GLBA, the Federal Reserve and the National Association of Insurance Commissioners (NAIC) have approved a broad two-way information sharing memorandum of understanding (MOU) intended as a model for adoption by the Federal Reserve and the individual DOIs. The Federal Reserve and the NAIC are also addressing the Federal Reserve's need for access to information residing in NAIC-based financial and regulatory databases.

The template Federal Reserve-DOI information sharing agreement also addresses issues related to consumer complaint information. According to the Insurance Department Resource Report, state insurance regulators received 405,323 consumer complaints and 3.5 million consumer inquiries in 1998. While the Federal Reserve-

DOI information sharing MOU allows for the sharing of such information, the intent is that the appropriate DOI will follow-up on all consumer complaints and inquiries relating to insurance activities. Any insurance related complaints received by the Federal Reserve will, therefore, be forwarded to the responsible state insurance supervisor for follow-up action.

The Federal Reserve is interested in obtaining statistical analyses of consumer complaints relating to the activities of bank holding company subsidiaries, including agents, broker-dealers, and insurance operations, in order to identify potential weaknesses in corporate governance and risk management. This information can, in part, be developed from NAIC and state consumer complaint databases. State DOIs will also be expected to apprise the Federal Reserve of material enforcement actions taken against the insurance entities and agents.

The Federal Reserve's reliance on functional regulators will require the coordination of two significantly different regulatory approaches. However, it will reduce regulatory overlap and burden on the supervised companies. Effective communication, including the sharing of pertinent information on supervised companies, will be essential to the success of these supervisory strategies. ■

For questions on the supervision and regulation of insurance activities in the Third Federal Reserve District, please contact Bernie Wennemer, Assistant Vice President, Federal Reserve Bank of Philadelphia, at (215) 574-6485 (bernie.wennemer@phil.frb.org).

Sign Here, Please!

continued from page 3

creditworthy. The guarantee must be based on the guarantor's relationship to the business or corporation and not on factors such as age, marital status, or national origin. For example, a creditor may not require guarantees only for women-owned or minority-owned businesses. A creditor may not automatically require that the spouses of the corporation's officers also sign the guarantee.

Conclusion

As previously stated, the signature rules in Regulation B are complex. To ensure compliance and avoid violations, management should initiate the following measures:

- Maintain an awareness of changes in consumer legislation and periodically review policies and procedures relative to Regulation B.
- Ensure that loan forms and supporting documentation are in compliance with the regulation.
- Periodically provide training to loan processors, lending staff, and other key personnel to ensure compliance with the restrictions of the regulation regarding spousal signatures for consumer and business credit.
- Ensure that loan documentation is maintained in accordance with the record retention requirements of the regulation.

If you have any questions about the signature requirements of Regulation B, please contact Carletta M. Longo, Examiner, (carletta.longo@phil.frb.org) at (215) 574-3458, John D. Fields, Supervising Examiner, (john.fields@phil.frb.org) at (215) 574-6044, or Connie Wallgren, Manager, Consumer Compliance and Community Reinvestment Act Examinations Unit, (connie.wallgren@phil.frb.org) at (215)574-6217. ■

Signature Rules: Regulation B, a pamphlet prepared by this Reserve Bank, may be obtained on the Reserve Bank's web site at <http://www.phil.frb.org/src/compliancecra/ index.html> or by contacting Denise Mosley (denise.mosley@phil.frb.org) at (215) 574-3729.

SVP Commentary on…
Career Development

continued from page 1

organization's requirements, allowing the individual to grow personally while helping the organization achieve its strategic goals. It is clear that this type of investment in the workforce produces higher business returns. In fact, many organizations have realized that career development is more than "nice-to-have"; it is a business necessity with a direct impact on competitive advantage and profitability. Today's top leaders recognize this, and continuously seek development opportunities for their people.

An organization's strategic plan and vision and its support for learning form the foundations of an effective career development plan. Without a well-defined strategic plan and vision, the organization would not know where it is going, and assuredly would never get there. Likewise, without a well-defined strategic plan, employees would not be able to align their career development plans with the organization. This misalignment of employees' career development plans and the organization's strategic direction would lead to a less effective organization, and might increase staff turnover.

The organization must also instill a culture that is supportive of continuous learning, and provide the time and resources to foster career development. Effective learning organizations are those organizations that actively encourage employees to create, acquire, transfer, and use knowledge, for their personal development and for the benefit of the organization. Through this process, a learning organization builds its employees' capacities to think in new ways and to act based upon the new knowledge. Today, ideas are the fuel for competitive advantage, and organizations that encourage continuous learning are better ensuring their own success.

Armed with the organization's strategic plan and immersed in a learning culture, employees can examine their goals, strengths, and weaknesses, and identify advancement opportunities and development activities that are consistent with their personal career objectives and the organization's needs. This might include staying current with changes in the industry and workplace, enriching their present job, improving or developing new skills, or preparing for future career directions.

Employees, managers, and organizations all have specific roles to play in the career development process. Although the organization should act as the enabler, each employee is ultimately responsible for identifying the career development opportunities that are consistent with his or her goals and the organization's strategic direction. As the bridge between the organization and the employee, each manager should ensure that the career development culture is alive and thriving in their business unit.

The success of career development initiatives will be critical to ensuring that an organization is able to remain an attractive workplace for highly motivated professionals, fostering an environment of career building that produces leadership for the future. In addition, these new initiatives will help staff to be highly effective and motivated in today's challenging and rapidly changing financial and regulatory environment. ■

Recognizing the organizational benefits of career development, the Federal Reserve System recently implemented a Continuing Professional Development (CPD) Framework for bank supervision and regulation staff throughout the System. The Framework is discussed in more detail in SR 01-02, *Framework for Continuing Professional Development of the Federal Reserve Examination and Supervisory Staff.*

The Framework is based on the belief that learning (i) supports strategic business objectives; (ii) is a personal responsibility to be supported by front-line managers and available resources; and (iii) comes from a variety of experiences beyond formal classroom instruction. The approach implicitly recognizes that all staff members must continually advance and refine their skills and knowledge if the Federal Reserve is to retain its ability to effectively function in a dynamic supervisory environment. This strategy supports the System's objective to evolve toward a culture that more formally emphasizes continuous learning.

Subprime Lending Guidance Issued

On January 31, 2001, the Board of Governors, along with the OCC, the FDIC, and the OTS, issued expanded examination guidance for subprime lending programs. This expanded interagency guidance supplements that issued on March 1, 1999. Both interagency statements are available on the Board of Governors' web site, as follows:

SR 01-04, *Subprime Lending,* issued January 31, 2001
http://www.federalreserve.gov/boarddocs/SRLETTERS/2001/sr0104.htm

SR 99-6, *Subprime Lending,* issued March 1, 1999
http://www.federalreserve.gov/boarddocs/SRLETTERS/1999/SR9906.HTM

In the next issue of *SRC Insights*, SRC staff will explore issues related to Subprime Lending. ■

Check Out New Content on phil.frb.org!

Do you offer Internet Banking? We recently added a page on Internet Banking where you can find links to guidance disseminated by the Federal Reserve and other federal banking agencies regarding Internet and electronic banking. Find it at <www.phil.frb.org/src/examinations/internetbanking.html>.

Interested in commenting on new and proposed regulations? You can now link to the Board of Governor's regulations reference page from SRC's web site at <www.phil.frb.org/src/regulations/index.html>.

Have a question about a regulation? On our Regulatory Contacts web page, you will find a list of contacts for each regulation from both SRC and the Bank's Community Affairs Department. Find out whom to call at <www.phil.frb.org/src/regulations/regcontact.html>. ■

Whom To Call?

Domestic Safety and Soundness

Louis N. Sanfelice, VP	574-6470
Dianne Lee Houck	574-4138
Bernard M. Wennemer, AVP	574-6485
Douglas A. Skinner	574-4310
Eric A. Sonnheim	574-4116
Michael P. Zamulinsky, AVP	574-4136
Robert E. Richardson	574-4135

Enforcement & Off-Site Integration

Louis N. Sanfelice, VP	574-6470
Eileen P. Adezio, AVP	574-6045
Mary G. Sacchetti	574-3848
Frank J. Doto	574-4304

Consumer Compliance & CRA

A. Reed Raymond, VP	574-6483
Constance H. Wallgren	574-6217

IT & Fiduciary Supervision

John J. Deibel, VP	574-4141
John V. Mendell	574-4139

Global Supervision

John J. Deibel, VP	574-4141
Elisabeth C. Videira-Dzeng, AVP	574-3438

Regulatory Applications

John J. Deibel, VP	574-4141
William L. Gaunt, AVP	574-6167
James D. DePowell	574-4153

Capital Markets, Payment Card Studies, & Special Studies

Joanna H. Frodin, VP	574-6419
Scott A. Weihrauch	574-4389
Vincent J. Poppa	574-6492

Discount Window and Reserve Analysis

Vish P. Viswanathan, VP	574-6403
Dennis S. Chapman	574-6596
Gail L. Todd	574-3886

NEXT ISSUE

Merchant Banking Activities

Supervisory Implications of Subprime Lending

Consumer Compliance Update

The views expressed in this newsletter are those of the authors and are not necessarily those of this Reserve Bank or the Federal Reserve System.

Editor.................Cynthia L. Course

SRC Insights is published quarterly and is distributed to institutions supervised by the Federal Reserve Bank of Philadelphia. The current and prior issues of *SRC Insights* are available at the Federal Reserve Bank of Philadelphia's web site at www.phil.frb.org. Suggestions, comments, and requests for back issues are welcome in writing, by telephone ((215) 574-3760), or by e-mail (Cynthia.Course@phil.frb.org). Please address all correspondence to: Cynthia L. Course, Federal Reserve Bank of Philadelphia, SRC - 7th Floor, Ten Independence Mall, Philadelphia, PA 19106-1574.

FEDERAL RESERVE BANK OF PHILADELPHIA