

Compliance Corner



FEDERAL RESERVE BANK OF PHILADELPHIA

Banks and the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act

by Kenneth J. Benton, Consumer Regulations Specialist

Banks and credit card companies lobbied Congress for several years to amend the Bankruptcy Code because of an increasing number of bankruptcy filings¹ and evidence that debtors were abusing the existing code. On April 20, 2005, President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act into law. The act makes the most sweeping changes to the Bankruptcy Code since its enactment in 1978, amends the Truth in Lending Act (TILA), and directs the Board of Governors of the Federal Reserve System (the Board) to amend Regulation Z, the Board's implementing regulation for TILA. The act's provisions became effective on October 17, 2005, except for the changes to TILA and Regulation Z, which become effective 12 months after the Board publishes its final regulations. This article reviews the Bankruptcy Code changes that affect banks.²

Means Test for Debtors Filing Under Chapter 7

The act's most significant and controversial provision is the Chapter 7 means test, which limits filings under Chapter 7 to debtors who cannot afford to repay their debts. Debtors can file under Chapter 7 without limitation if their income falls below

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¹ In 1979, the first year of filings for the current Bankruptcy Code, debtors filed 225,000 individual petitions. By 2004, filings increased dramatically to more than 1.5 million petitions. Chapter 7, the liquidation chapter, accounted for 71.5 percent of nonbusiness filings in 2004, or over 1.1 million cases.

² A comprehensive review of all of the act's amendments to the Bankruptcy Code is beyond the scope of this article. The American Bankruptcy Institute has a webpage with the complete text of the bill and discussion and analysis of its major changes at <www.abiworld.net/bankbill/>.

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Awash in Flood Regulations: Keeping Your Head and Portfolio Above Water, Part II

by Carletta M. Longo, Senior Examiner

Last quarter's *Compliance Corner* contained the first of two articles on the mandatory flood insurance requirements of the 1994 National Flood Insurance Reform Act (Reform Act) and its application to lenders under Regulation H, the Board's implementing regulation for the Reform Act. The first installment provided a general overview of the Mandatory Purchase of Flood Insurance Guidelines published by the Federal Emergency Management Association (FEMA guidelines). This second installment reviews the more problematic areas encountered by lenders and regulators.¹

Land Value Versus Property Value

Lenders sometimes write loans on buildings situated on land located in a special flood hazard area (SFHA) whose value alone provides sufficient security for the loan, without regard to the building's value. The question often arises in these circumstances whether the lender must still require the borrower to obtain flood insurance. The answer is unequivocal because the Reform Act and Regulation H specify that when a lender has a security interest in a building in an SFHA, regardless of its value, the lender cannot close the loan until it has verified that the borrower obtained flood insurance for the property.

The question of flood insurance coverage for high-value land with relatively low-value buildings is often an issue in agricultural lending. Regulators have made it clear that Congress, in enacting the Reform Act, did not differentiate agriculture from other types of lending, and therefore agriculture borrowers also must comply. The value of the land should be deducted from the overall value of the secured property when calculating the required amount of flood insurance.

Buildings in the Course of Construction

For new construction, lenders are often uncertain when flood coverage is required: is it before, during, or after construction is completed? For a structure being built in an SFHA that will be a walled and roofed building eligible for coverage, flood insurance must be purchased to provide coverage *during* the construction period. Thus, when a development or interim loan is made to construct insurable improvements on land, flood insurance coverage must be purchased.

¹ A complete review of the National Flood Insurance Program (NFIP) is beyond the scope of this article. The Federal Emergency Management Association (FEMA) maintains a comprehensive website about the program at www.fema.gov/nfip/.

The only practical way to implement this is to require the borrower to purchase the policy when the development loan is made, with coverage becoming effective when construction commences and existing in an amount that satisfies the mandatory purchase requirement.

When a structure is yet to be walled and roofed, the material to be used during construction is eligible for flood insurance, but it is subject to certain underwriting restrictions. The National Flood Insurance Program (NFIP) conforms its practices, to the extent possible, to those of fire insurers by providing insurance coverage on materials, which begins when construction takes place. For more detailed information, refer to FEMA guidelines at <www.fema.gov/nfip/mpurfi.shtm>.

Residential Condominium Associations

The NFIP offers a specific policy for residential condominium associations called the Residential Condominium Building Association Policy (RCBAP). The RCBAP allows condominium associations to purchase up to \$250,000 in coverage for each unit in the building or the replacement cost of the building, whichever is less. For instance, in a 10-unit condominium building, the maximum amount of coverage is \$2,500,000 (\$250,000 x 10). However, if the replacement value of the building is \$2,000,000, the maximum coverage is \$2,000,000. A condominium association may opt to purchase flood coverage under the RCBAP, even though individual owners do not have mortgages on their units.

This area can be problematic because the RCBAP is for all of the units, and the lender must determine how coverage applies to a specific borrower's unit. When making a loan on a condominium unit located in an SFHA, lenders should verify whether the association has an RCBAP in place that provides adequate flood



insurance coverage at the time the loan is made and also that it will continue for the term of the loan.

A unit owner's mortgage lender has no direct interest in an RCBAP and is not an additional named insured. Because of this, lenders should take steps to protect their interest in the proceeds of a policy in the event of a claim. In the loan documents, lenders should require borrowers to fully assign all future claims under

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any insurance purchased or in which the borrower is named as an insured, such as an RCBAP. The lender should also notify the flood insurance carrier of the assignment. Otherwise, the carrier will send the proceeds of a claim to the borrower.

If a lender determines that the unit owner's coverage under the RCBAP is insufficient to meet the mandatory requirements, the lender can ask the

borrower to purchase a dwelling policy to bridge the gap. However, the maximum benefit payable under the NFIP for a single condominium unit under the combination of the RCBAP and the dwelling policy is \$250,000. When both the RCBAP and a dwelling policy cover the same unit, the RCBAP is considered primary insurance.

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Amendments to CRA Regulations

by Carole Foley, Supervising Examiner

On July 19, 2005, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (the agencies) jointly announced approval of identical final amendments to their respective Community Reinvestment Act (CRA) regulations, which became effective on September 1, 2005. The Office of Thrift Supervision has not adopted these amendments. This article highlights the key points of the CRA amendments adopted by the agencies.

Intermediate Small Banks: Banks with Assets Between \$250 Million and \$1 Billion

The amendments are intended to reduce regulatory burden on small banks with an asset size between \$250 million and \$1 billion and to make their CRA evaluations more flexible while still encouraging them to invest in their communities. To accomplish these goals, the amend-

ments contain two important changes for these “intermediate small banks.”

Exemption from data collection and reporting. Intermediate small banks will no longer be required to collect and report CRA loan data on small farm, small business, or community development loans or data on the location of mortgage loans outside of metropolitan areas. Despite the data collection exemption, the agencies will continue to evaluate intermediate small banks on their lending performance (including data reported under HMDA, if applicable) and to summarize the performance in public evaluations.

CRA evaluations. Intermediate small banks will be eligible for a two-part CRA evaluation test that includes a streamlined lending test and a community development test. A bank will need a satisfactory rating on

The new test
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each test to receive a CRA rating of satisfactory.

The **lending test** evaluates intermediate small banks using the same criteria currently employed to evaluate small banks. The criteria evaluate the distribution of a bank's loans among geographic areas and borrowers of varying incomes, similar to the large bank criteria, but they do this on a more streamlined basis.

The **community development test** evaluates an intermediate small bank's community development performance as a whole, instead of on the three separate tests format based on loan, investment, and service criteria. This format will continue to be used for large banks. The new test emphasizes the substance of a bank's performance while being flexible about its form. A bank's record of providing banking services to low-income people, including opening branches in low-income areas, will be considered under the community development test.

Community Development in Rural Areas

To provide banks with additional incentives to invest in rural development, the new CRA amendments increase the number of rural areas in which bank activities, by banks of any size, qualify for community development consideration. Eligible areas will include not only low- and moderate-income census tracts, as provided under the existing regulation, but also distressed or underserved middle-income rural census tracts identified by objective criteria. Designated disaster areas, whether urban or rural, are also considered eligible areas. The list of distressed or underserved nonmetropolitan middle-income geographies is located on the Federal Financial Institutions Examination Council's (FFIEC) CRA website at <www.ffiec.gov/cra>. Staff at the Board of Governors of the Federal Reserve System will update this list annually.

Illegal Credit Practices

The amendments also clarify when evidence of discrimination or other illegal lending practices by a bank or its affiliate might reduce its CRA rating. Under the amendments, a bank's rating is adversely affected by such practices, regardless of whether they involve loans in the bank's assessment area(s) or in any other location or geography. In addition, a bank's CRA rating is also adversely affected by evidence of such practices by any bank affiliate in connection with loans inside the bank's assessment area(s), if any loans of that affiliate have been considered in the bank's CRA evaluation.

Additional Guidance

The Federal Reserve's press release and the CRA amendments are available at <www.federalreserve.gov/boarddocs/press/bcreg/2005/20050719/default.htm>. Examination procedures for intermediate small banks are available on the FFIEC's website at <www.ffiec.gov/cra>.

In addition, on November 10, 2005, a proposal to revise existing CRA guidance on an inter-agency basis was released. The revisions, in a question and answer format, address topics related to the revisions the agencies made to their existing regulations that implement the CRA.

The amendments also clarify when evidence of discrimination or other illegal lending practices by a bank or its affiliate might reduce its CRA rating.

When final, these questions and answers will be added to the Interagency Questions and Answers, an existing document that contains staff guidance for examiners and agency personnel, financial institutions, and the public.

If you have any questions about the CRA amendments, please contact Supervising Examiner Carole Foley (carole.foley@phil.frb.org) or Supervising Examiner John D. Fields (john.d.fields@phil.frb.org) through the Regulations Assistance Line at (215) 574-6568. □

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the median income of their state of residence, as calculated by the Census Bureau.³ But if their income exceeds the state median, they are subject to a means test to determine whether they are abusive filers, a phrase used in the act to identify debtors who seek an immediate discharge of their debts under Chapter 7 when they have the ability to repay a portion of their debt in a Chapter 13 payment plan.

The means test precludes debtors from filing under Chapter 7 if they had at least \$166.67 in net monthly income available after allowed deductions (i.e., \$10,000 over five years), or if they had between \$100 and \$166.66 in net monthly income available (i.e., \$6,000 to \$10,000 over five years) and were able to repay at least 25 percent of their nonpriority unsecured debt over five years. The act also specifies that debtors whose income exceeds the state median for the six months prior to filing will have to file a five-year Chapter 13 plan, instead of the three-year plan selected by most debtors. Lengthening the payment plan period to five years should result in more unsecured debt being repaid. A Chapter 7 debtor who is flagged as an abusive filer can avoid dismissal or conversion to Chapter 13 only by documenting special circumstances, such as a serious medical condition, that would either decrease their income or increase their expenses, thereby causing their net monthly income to fall within the above guidelines. These provisions will likely decrease the number of Chapter 7 filings, where unsecured creditors typically receive

nothing, and increase Chapter 13 filings, where unsecured creditors typically are repaid a portion of their debt. Therefore, banks offering unsecured debt to consumers in the form of credit cards and unsecured loans should benefit.

Serial Bankruptcy Filings

Some debtors file serial bankruptcies with the goal of indefinitely postponing a foreclosure sale of their home or automobile. These cases are an enormous frustration for secured creditors, who incur significant costs in attorney's fees and out-of-pocket expenses and suffer years of delays before they are finally able to foreclose on their security. In Delaware County, Pennsylvania, for example, the sheriff's office requires a \$2,000 deposit for a sale of real property, only a portion of which is refunded if the sale is cancelled. The resulting expenses can easily eliminate any equity cushion remaining in the collateral and ultimately result in a loss for a bank.

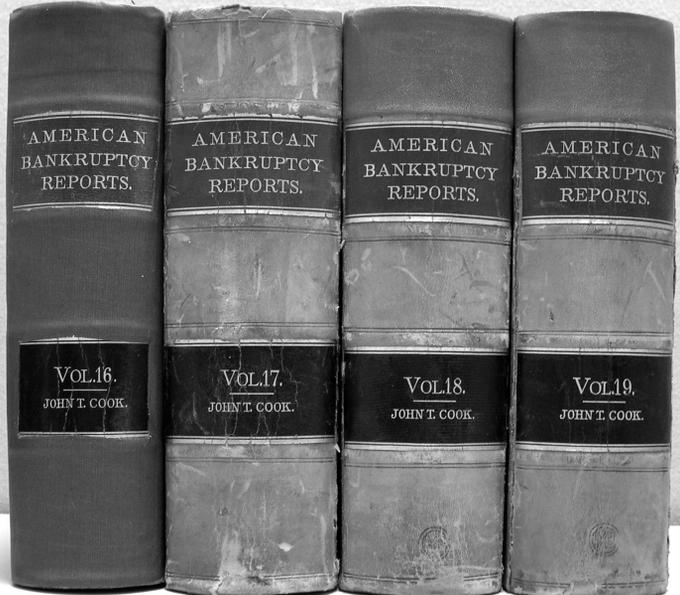
The act creates several obstacles to serial filings. If a debtor files a new bankruptcy within one year after the dismissal of an earlier case, the automatic stay terminates in the second case 30 days

after filing of the second case, unless the debtor demonstrates the filing was in good faith. Further, if a debtor files a third case within the one-year period, the automatic stay does *not* apply, though it can be instated if the debtor can establish that the third case was filed in good faith.

The act also provides that the automatic stay does not apply to a creditor's attempt to enforce a lien or security interest in a bankruptcy in which the debtor was ineligible to file under Section 109(g) of the Bankruptcy Code, which defines who can be a debtor. Serial filers are usually ineligible to file under section 109(g) for six months after the dismissal of their last bankruptcy. Thus, if a debtor files a second bankruptcy within six months of a prior dismissal, the automatic stay

A Chapter 7 debtor who is flagged as an abusive filer can avoid dismissal or conversion to Chapter 13 only by documenting special circumstances.

³ The United States Trustee Program, which oversees bankruptcy cases, publishes the median income tables for all states on its website at <www.usdoj.gov/ust/bapcpa/bci_data/median_income_table.htm>. In the Third District, the median income for a two-person household is \$44,361 (PA), \$58,547 (NJ), and \$51,955 (DE). The means test is expected to affect about 20 percent of Chapter 7 debtors.



would not apply to a foreclosure sale. Lenders foreclosing on an asset should therefore move promptly after the dismissal of a bankruptcy to relist it with the sheriff's office. For banks that have experienced the exasperation of scheduling foreclosure sales of mortgaged property, only to see them repeatedly cancelled by serial bankruptcy filings, these amendments should provide a welcome benefit.

Debt Reaffirmation Agreements

The act requires additional disclosures for debt reaffirmation agreements, including a summary of the reaffirmation agreement, disclosure of the amount reaffirmed, the annual percentage rate, the security, and the repayment schedule. The act also requires additional disclosures to debtors, including their right to cancel the reaffirmation agreement any time up until the discharge order is entered. A bankruptcy judge can reject a reaffirmation agreement if it appears a debtor lacks sufficient funds to make the agreed-upon payments.⁴

Limits on Lien Stripping in Chapter 13

Under current law, when the value of a secured credi-

⁴ Credit unions are exempt from this provision.

tor's claim exceeds the value of the collateral, a debtor can strip down the secured claim to the value of the collateral and treat the remainder as unsecured, on which the lender will likely incur a loss. This procedure, known as a cram down, is frequently a problem with car loans because cars rapidly depreciate in value.

The act prohibits a debtor from stripping down a lien on consumer goods purchased within one year preceding the bankruptcy and on cars purchased within two and a half years preceding the bankruptcy. A debtor would have to repay the full value of the claim if the loan were made within the lookback period, regardless of the vehicle's actual value. These provisions will significantly benefit banks with car loan operations.

Tightening Discharge Rules

The act provides additional reasons for denying discharge of a claim and strengthens existing ones. Of particular interest to banks with credit card operations, the act lowers the threshold for presuming a denial of discharge for luxury goods and cash advances. The amount for the "luxury goods" threshold is lowered to \$500 from \$1,225, and the cash advances threshold is lowered to \$750 from \$1,225. The lookback period for these items is lengthened from 60 to 90 days for luxury goods and from 60 to 70 days for cash advances. Thus, if a debtor purchases luxury goods of \$500 or more within 90 days of filing bankruptcy or obtains a cash advance of \$750 or more within 70 days of filing bankruptcy, the debt

will not be discharged. These provisions will help reduce losses on these items.

will not be discharged. These provisions will help reduce losses on these items.

Prohibition Against Ride-Through

Under current law in some circuits, including the Third Circuit, a debtor can retain secured property in a Chapter 7 filing, after discharge, without filing a reaffirmation agreement by continuing to make installment payments on the debt. This practice is known as "installment redemption" or "ride-through." The act prohibits this practice and instead requires a debtor to file a statement of intention for the property when the petition is filed.

A bankruptcy judge can reject a reaffirmation agreement if it appears a debtor lacks sufficient funds to make the agreed-upon payments.

Mystery Notice Problem Addressed

Creditors frequently receive bankruptcy notices that lack an account number or other information that would enable them to identify the account. To address this problem, notices must now be sent to the address specified by the creditor for correspondence and must include the last four digits of the debtor's tax identification number and the debtor's account number. If a debtor fails to give proper notice, the debt is not discharged. Furthermore, as an additional means of ensuring that creditors are notified when their customers file for bankruptcy, the act permits a creditor to file a notice of address with any bankruptcy court. If the notice is filed, the bankruptcy court notifies the creditor whenever debtors list the creditors in their bankruptcy petitions. Thus, if a debtor listed the incorrect address for the creditor, the creditor would still receive notice.

Debtors' Duties

In contrast with existing law, the act requires debtors to perform certain duties or suffer dismissal or other serious consequences.

Statement of intention regarding property. Debtors with property secured by a lien must file a statement of intention before the first meeting with their creditors. The statement must specify whether the debtor intends to surrender, reaffirm, or redeem the debt. If a debtor fails to comply, the automatic stay is lifted for the property *without* the filing of a motion.

Mandatory credit counseling and financial management courses. The act requires a debtor to complete a consumer credit counseling course from an approved nonprofit agency and to file a certificate of completion within 180 days before filing for bankruptcy. In addition, debtors must complete an education course in personal financial management approved by the U.S. Trustee before they receive a discharge of debts. Debtors are ineligible for discharge unless they complete both the credit counseling and financial management courses.

Providing tax returns and other financial documents. The act requires debtors to file certain financial documents with the bankruptcy court within 45

days of filing the bankruptcy petition, including an itemized statement of net income, a statement disclosing any reasonably anticipated income or expenditures over the 12 months following the filing of the petition, and pay stubs for the 60-day period preceding the bankruptcy. Debtors must also provide the trustee with their most recent tax return, and they have a duty to provide future tax returns throughout

the course of the bankruptcy. Failure to file the required documents will result in automatic dismissal of the case on the 46th day. A debtor must also provide proof of insurance to secured creditors on property subject to a security interest.

Establishing IRS Standards for Expenses

To prevent debtors from exaggerating their living expenses, the act establishes national standards for allowable amounts for various living expenses based on guidelines promulgated by the IRS. This will benefit creditors by increasing the

amount of income available for a Chapter 13 plan.

Sanctions Against Debtors' Counsel

The act places greater responsibility on debtors' counsel to ensure the accuracy of documents filed with the bankruptcy court. First, attorneys must perform a reasonable investigation into the circumstances of a bankruptcy petition, pleading, or written motion they file with the court. Second, an attorney's signature on a bankruptcy petition constitutes a certification that, after conducting a reasonable investigation, counsel has no knowledge that the information in the schedules is incorrect. Counsel can be ordered to pay attorney's fees for any violations.

The act does not define "reasonable investigation," but attorneys must be able to document their efforts to verify the information in debtors' schedules before filing. This might include obtaining a credit report; verifying whether debtors have filed prior bankruptcies; reviewing bank statements, tax returns, and pay stubs; and examining property valuations of taxing authorities. The act also contains a specific provision authorizing sanctions against an attorney if a case is converted from Chapter 7 to Chapter 13 and the court determines the attorney did not adequately investigate the

Attorneys must perform a reasonable investigation into the circumstances of a bankruptcy petition, pleading, or written motion they file with the court.

debtor's eligibility to file under Chapter 7. These potential sanctions will place pressure on debtors' counsel to ensure the accuracy of their filings.

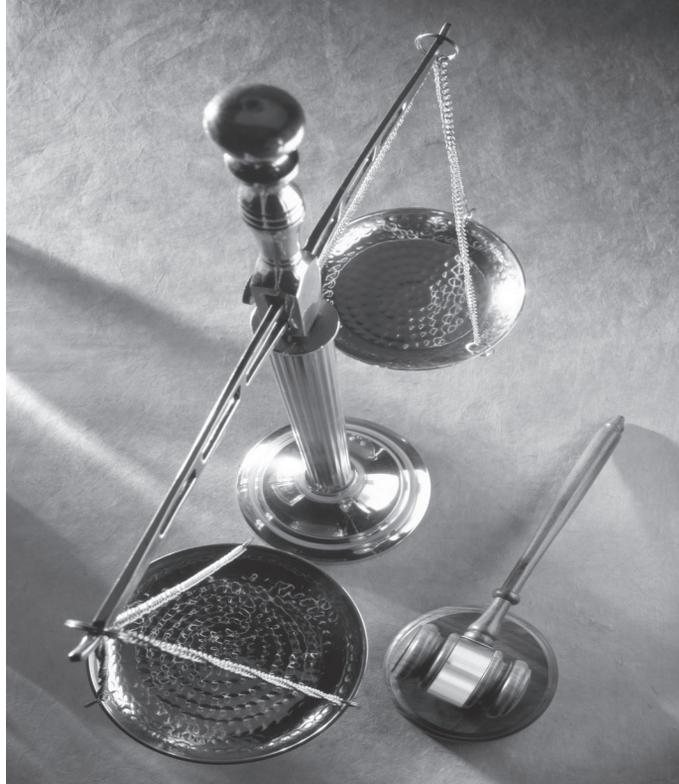
Exemptions

To prevent debtors from forum shopping for the most generous state exemptions, the act permits debtors to use a state's exemptions only if they resided there two years before filing, in contrast with the current requirement of six months. If debtors have not been domiciled in a single state for the two-year period, the Reform Act uses the state where they resided for the six-month period two years prior to filing bankruptcy. This means that a debtor must wait at least two years after moving to a new state to qualify to use that state's exemptions.

Homestead exemptions also have changed. Some states, notably Texas and Florida, have unlimited homestead exemptions, which prevent creditors from reaching any portion of a debtor's principal residence regardless of its value. Under the act, a debtor who resides in a state for less than three years and four months before filing bankruptcy is subject to a maximum homestead exemption of \$125,000. If there is evidence of fraud, the homestead equity is always limited to \$125,000, regardless of the length of ownership. The act also limits homestead exemptions to \$125,000 for debts arising from securities laws violations, fiduciary fraud, or racketeering or for crimes or intentional torts that result in serious bodily injury or death.

Protection for Debtors

A debtor can reduce unsecured creditors' claims by up to 20 percent in limited circumstances. If a credit counseling agency approved by the United States Trustee Program proposes to a creditor, at least 60 days before filing for bankruptcy, to settle a debt for at least 60 percent of the value of the debt and the creditor unreasonably refuses, a debtor can file a motion to reduce the creditor's claim by up to 20 percent.



Final Thoughts

In summary, the act makes substantial changes to consumer bankruptcy law that will make it significantly more difficult for consumers to file bankruptcy and to receive a discharge. It will take some time to see how the changes are implemented and how debtors respond, but it appears that banks should fare better under the new law. Indeed, in the weeks leading up to October 17, 2005, bankruptcy courts around the country experienced a record number of Chapter 7 filings, as debtors raced to file before the new law took effect.

If you have any questions about this article, please contact Consumer Regulations Specialist Kenneth J. Benton (kenneth.j.benton@phil.frb.org) or Supervising Examiner John D. Fields (john.d.fields@phil.frb.org) through the Regulations Assistance Line at (215) 574-6568. □



Last quarter we introduced a new layout design for *SRC Insights* and *Compliance Corner*.

We would appreciate your feedback on the new design. Please direct any comments and suggestions to Cynthia L. Course (cynthia.course@phil.frb.org) at (215) 574-3760.

Awash in Flood Regulations: Keeping Your Head and Portfolio Above Water, Part II *...continued from page CC3*

If the RCBAP lapses during the term of the loan, the lender must notify the borrower that there is a 45-day limit to obtain a policy for the amount of the loan or the maximum amount of coverage available, whichever is less, and that the lender will obtain a policy if the borrower fails to do so within the 45 days.² It is important to note that while cooperatives are similar to condominiums, they are not covered by the RCBAP. The NFIP requires that cooperatives be insured through the general property policy, instead of the RCBAP.

Coinsurance penalty. If a flood insurance policy is for the lesser of 80 percent of the replacement value of the property or the maximum amount of coverage available under the NFIP, a coinsurance penalty applies. This penalty reduces the amount paid on a claim by the ratio of the value of the replacement policy divided by the value of the property. For example, assume a \$5 million condominium is insured for only \$3 million. Since \$4 million is required for replacement coverage (80 percent of \$5 million), the coinsurance penalty applies. Only 75 percent (\$3 million divided by \$4 million) of any loss would be recovered. Therefore, the NFIP encourages an association to purchase coverage equal to at least 80 percent of the replacement cost of the building to avoid the penalty. If the 80 percent threshold is met, the NFIP pays 100

percent of all covered losses up to the limits of the policy minus any deductible.

Dwelling policy. When the condominium association fails to obtain full replacement cost coverage, the unit owner can acquire supplemental building coverage by purchasing a dwelling policy in excess of the association policy. The policies are coordinated such that a unit owner's policy responds to shortfalls in the association's building coverage pertaining either to improvements owned by the insured or to assessments by the condominium association. Assessment coverage is available under the unit dwelling policy, which covers the risk of a special assessment against the unit owner from a condominium association because of damage to common areas due to flooding. Residents are advised to purchase contents coverage separately because contents are not covered under the dwelling policy or the RCBAP.

Recent events in the gulf states vividly demonstrate that flood insurance is critical for the financial stability of individuals living in and financial institutions operating in SFHAs.

Nonresidential Condominium Associations

To purchase coverage under the NFIP on a nonresidential condominium building, a condominium association must use the general property policy. Both building and contents coverage are available separately, in amounts up to \$500,000 per nonresidential building.

Timeshares

NFIP's coverage of timeshares depends on the property law of the state where the property is located. If state law treats the timeshare as real property (fee simple), then the timeshare is treated like a condominium and must be covered by an RCBAP. Also, the timeshare unit owner must have an ownership in the unit similar to that of a condominium unit owner. In nonfee jurisdictions, where the title remains with the building owner who has the full insurable interest in the property, a general property policy must be used.

² To facilitate the force placement of flood insurance, FEMA created the Mortgage Portfolio Protection Program (MPPP). This program maintains a list of insurers from whom lenders can obtain force placement insurance with limited underwriting information and special flat flood insurance rates. The policies under MPPPs are for one year, with the option of renewing for another year. FEMA publishes a comprehensive document describing this program on its website at <www.fema.gov/pdf/nfip/mpapp9.pdf>.

The Secondary Market

Lenders participating in the secondary market through government sponsored enterprises (GSE), including Freddie Mac and Fannie Mae, should consult the GSE's guidelines for flood insurance requirements. Fannie Mae's guidelines are available at <www.allregs.com/efnma/index.asp> under "Selling Guide." Freddie Mac's guidelines are available at <www.allregs.com/fhlmc/index.asp>.

Final Thoughts

Recent events in the gulf states vividly demonstrate that flood insurance is critical for the financial stability of individuals living in and financial institutions operating in SFHAs. Between 2002 and 2004, the Board of Governors of the Federal Reserve System imposed penalties on 16 state member banks for violating the flood insurance rules. The penalties ranged from \$1,750 to \$34,100 and were imposed when a pattern or practice was noted, not for isolated incidents.

Lenders should be particularly careful to ensure compliance with the most frequently violated sections of Regulation H, namely Section 208.25(f)(1)'s requirement that lenders use the standard flood hazard determination form when writing loans and Section 208.25(c)'s requirement that lenders ensure that borrowers living in an SFHA obtain flood insurance. This

is an appropriate time for lenders to ensure that their loan portfolios are adequately protected and that lending procedures are in compliance with the Reform Act and Regulation H.

If you have any questions regarding this article, please contact Senior Examiner Carletta M. Longo (carletta.longo@phil.frb.org) or Supervising Examiner John D. Fields (john.d.fields@phil.frb.org) through the Regulations Assistance line at (215) 574-6568. □

On November 22, 2005, legislation was signed, allowing the National Flood Insurance Program to borrow up to \$18.5 billion to settle flood insurance claims due to the unprecedented number of claims filed in 2005. As a result of the record breaking hurricane season, FEMA currently expects 225,000 claims to be filed at an estimated cost of \$23 billion. FEMA has not ruled out the possibility that additional borrowing authority may be necessary to settle all outstanding claims.

Compliance Alert: Agencies Finalize FACT Act Rules on Medical Information

On November 17, 2005, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision issued final rules under the Fair Credit Reporting Act (FCRA) that create exceptions to the statutory prohibition against obtaining or using medical information in connection with credit eligibility determinations.

The exceptions permit creditors to obtain or use medical information in connection with credit eligibility determinations, where necessary and appropriate for legitimate purposes, compliant with the Congressional

intent to restrict the use of medical information for inappropriate purposes. Additionally, the final rules specify the circumstances in which certain creditors may share medically-related information among affiliates without becoming consumer reporting agencies.

The final rules are nearly identical to the interim final rules issued by the agencies in June 2005 and become effective on April 1, 2006. The final rules are available on the Federal Reserve Board's website at <www.federalreserve.gov/boarddocs/press/bcreg/2005/20051117/default.htm>.

Ongoing Review of Regulation Z Open-End Credit Rules

The Federal Reserve Board (the Board) is currently conducting a comprehensive review of Regulation Z, *Truth in Lending Act*, which implements the Truth in Lending Act (TILA). The multi-stage review is expected to span several years, with the first stage focusing on open-end (i.e., revolving) credit, chiefly general-purpose credit cards and merchant-specific credit plans.

In December 2004, the Board published an initial advance notice of proposed rulemaking (ANPR) to commence a comprehensive review of the open-end credit rules and to solicit comment on a variety of issues relating to the format of open-end credit disclosures, the content of disclosures, and the substantive protections provided under the regulation. The comment period closed in March 2005.

On October 11, 2005, the Board issued for public comment its second ANPR concerning open-end credit rules. The second ANPR solicits public comment on how the Board should implement amendments to TILA made by the Bankruptcy Abuse

Prevention and Consumer Protection Act of 2005 (the Bankruptcy Act). The amendments principally deal with open-end credit accounts and require new disclosures on periodic statements and on credit card applications and solicitations.

The Bankruptcy Act, which became effective on October 17, 2005, contains several amendments to TILA, including provisions requiring new disclosures for open-end credit accounts. The Board plans to implement the amendments as part of its review of Regulation Z and is publishing this second ANPR to reopen and extend the public comment period. Combining the two rulemakings will allow the Board to coordinate the changes to the TILA disclosures and should impose less regulatory burden on creditors.

Comments on the second ANPR must be received on or before December 16, 2005. The ANPR is available on the Federal Reserve Board's website at www.federalreserve.gov/boarddocs/press/bcreg/2005/20051011/default.htm.

Consumer Affairs Letters Are Available on the Federal Reserve Board's Website!

Earlier this year, the Division of Consumer and Community Affairs of the Federal Reserve Board made Consumer Affairs Letters available to the public. Commonly known as CA Letters, Consumer Affairs letters address significant policy and procedural matters related to the Federal Reserve System's consumer compliance supervisory responsibilities. The letters are sent to banking supervision staff at the Board and the Reserve Banks and, in some instances, to supervised banking organizations.

The letters are sequentially numbered by year. Currently, letters dating back to 2003 are located on the Federal Reserve Board's website at www.federalreserve.gov/boarddocs/caletters/.

Recently Released CA Letters:

- CA 05-9** *Revised Examination Procedures for the Fair Credit Reporting Act*
- CA 05-8** *Racial and Ethnic Control Groups Used in Fair Lending Analyses*
- CA 05-7** *Interagency Community Reinvestment Act Performance Evaluation Formats*
- CA 05-6** *Supervisory Practices Regarding Banking Organizations and Consumers Affected by Hurricane Katrina*
- CA 05-5** *Interagency Intermediate Small Bank Examination Procedures*