



FEDERAL RESERVE BANK *of* KANSAS CITY

May 3, 2013

**CA Letter 13-6 (Minimum Standards for Prioritization and Handling Borrower Files with Imminent Scheduled Foreclosure Sale) and CA Letter 13-7 (Statement on Deposit Advance Products)**

**To the Chief Executive Officer of Each Tenth District State Member Bank, Bank Holding Company, and Savings and Loan Holding Company:**

During the week of April 22, 2013, the Board of Governors of the Federal Reserve System (Federal Reserve Board) issued two separate letters: the first provided guidance on sound business practices for institutions engaged in residential mortgage servicing, including activities related to credit collection, loss mitigation, and foreclosure processing; and the other included a policy statement concerning consumer risk related to deposit advance products.

In CA Letter 13-6, the Federal Reserve Board confirms minimum standards that all regulated institutions should adopt in prioritizing and handling borrowers with imminent risk of foreclosure. In CA Letter 13-7, the Federal Reserve Board references the Consumer Financial Protection Bureau's April 24, 2013 white paper entitled "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings," and indicates that state member banks are expected to consider the risk of consumer harm and the potential for elevated compliance risk when designing and offering these products.

Copies of the CA Letters 13-6 and 13-7 are attached. Please direct any questions concerning the guidance or policy statement to Linda Painter, Consumer Affairs Department of the Federal Reserve Bank of Kansas City, at (800) 333-1010, or via email at [linda.painter@kc.frb.org](mailto:linda.painter@kc.frb.org).

Sincerely,

Michael R. Steckline  
Assistant Vice President



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

DIVISION OF CONSUMER AND  
COMMUNITY AFFAIRS

SR 13-9

CA 13-6

April 23, 2013

**TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK AND TO THE CHIEF EXECUTIVE OFFICER OF FINANCIAL INSTITUTIONS SUPERVISED BY THE FEDERAL RESERVE THAT ARE ENGAGED IN MORTGAGE SERVICING ACTIVITIES**

**SUBJECT:** Minimum Standards for Prioritization and Handling Borrower Files with Imminent Scheduled Foreclosure Sale

**Applicability to Community Banking Organizations:** This guidance applies to any financial institution supervised by the Federal Reserve, regardless of asset size, that engages in mortgage servicing activities.

### **Purpose**

The Federal Reserve is issuing this letter to set forth guidance on sound business practices for residential mortgage servicing that Federal Reserve supervised financial institutions<sup>1</sup> are expected to address in their collections, loss mitigation, and foreclosure processing functions. The guidance confirms the minimum standards that all regulated institutions are expected to adopt in prioritizing and handling borrowers' files with imminent risk of foreclosure.

### **Background**

The residential mortgage crisis revealed weaknesses in the servicing of residential mortgage loans.<sup>2</sup> These weaknesses were pervasive throughout the mortgage servicing industry and were centered in the administration of delinquent loans, loss mitigation practices, and

<sup>1</sup> Federal Reserve supervised financial institutions refers to state member banks, bank and savings and loan holding companies (including their non-bank subsidiaries), and U.S. branches and agencies of foreign banking organizations.

<sup>2</sup> See the April 2011 report on "Interagency Review of Foreclosure Policies and Practices" [http://www.federalreserve.gov/boarddocs/rptcongress/interagency\\_review\\_foreclosures\\_20110413.pdf](http://www.federalreserve.gov/boarddocs/rptcongress/interagency_review_foreclosures_20110413.pdf)

foreclosure processing. As a result, in February 2012, the Federal Reserve and Office of the Comptroller of the Currency (OCC) issued guidance to banking organizations subject to enforcement actions for deficient practices in mortgage loan servicing and foreclosure processing (“Consent Orders”) establishing certain minimum standards for the handling and prioritization of files with an imminent foreclosure sale (“February 2012 Guidance”). The February 2012 Guidance was intended to ensure that borrowers would not lose their homes without first receiving either a review of their foreclosure in accordance with the standards, at a minimum, or a full independent review under the Consent Orders. At those servicers subject to the February 2012 Guidance, examiners are continuing to monitor these institutions for compliance with this guidance.

As of March 2013, the servicers already subject to the February 2012 Guidance account for more than 57 percent of the residential mortgage industry’s total servicing volume. Consequently, the Federal Reserve and OCC have concluded that it is appropriate to broaden applicability of the guidance to encompass the remaining institutions subject to their respective jurisdictions that service residential mortgages, which collectively account for a significant portion of the residential mortgage industry’s remaining servicing volume. The standards set forth in the attached guidance reflect the February 2012 Guidance, with updates and modifications to account for its broadened applicability, and are consistent with previously issued statements by the Federal Reserve concerning financial institutions’ loss mitigation efforts.<sup>3</sup>

### **Supervisory Expectations**

The Federal Reserve expects financial institutions that service residential mortgages to act responsibly in their administration of delinquent mortgages and borrowers at imminent risk of foreclosure. Financial institutions must comply with safe and sound banking practices, federal, state, and local laws, third party investor requirements, and the Making Home Affordable Modification Program requirements, as well as other existing contractual and programmatic commitments, as applicable. Prudent business practices in servicing residential mortgage loans include ensuring that, prior to proceeding to a foreclosure sale:

- The loan is in default under applicable law and investor requirements;
- Any borrower complaints, appeals, or escalations have been considered and addressed;
- The borrower is not subject to specific legal protections such as those afforded under the Servicemembers Civil Relief Act<sup>4</sup> and bankruptcy law;
- The financial institution has the appropriate legal authority to foreclose;

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<sup>3</sup> Refer to SR letter 07-16/CA letter 07-4, “Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages.”

<sup>4</sup> For more information regarding the Servicemembers Civil Relief Act, see CA letter 11-6, “Revised Examination Procedures for the Servicemembers Civil Relief Act.”

- All appropriate notices have been provided to the borrower;
- Appropriate outreach and other loss mitigation efforts have been made;
- The loan is not currently in an active loss mitigation program;
- The borrower is not currently qualified or being considered for a loss mitigation action; and
- The financial institution is in compliance with all applicable federal, state, local, and other legal requirements.

The attached guidance confirms the minimum standards for the handling and prioritization of borrowers' files that are subject to an imminent (within 60 days) scheduled foreclosure sale. These minimum review criteria are intended to ensure a level of consistency across servicers, and should be used to determine whether a scheduled foreclosure sale should be postponed, suspended, or cancelled because of critical foreclosure defects in the borrower's file. The purpose of the guidance is to ensure that borrowers will not lose their homes without their files first receiving a pre-foreclosure sale review that, at a minimum, meets the standards listed in the attached guidance. The Federal Reserve expects that each institution subject to this guidance will promptly confirm that its existing processes comply with this guidance. If an institution has not already implemented these standards, it must implement them immediately.

These standards are not intended to incorporate the final rules amending Regulation X and Regulation Z issued by the Consumer Financial Protection Bureau (CFPB) on January 17, 2013, and effective on January 10, 2014, which govern mortgage servicers' loss mitigation and foreclosure processing functions.<sup>5</sup> The Federal Reserve expects that all servicers will undertake appropriate action in a timely manner to ensure their practices will be compliant with the new rules by the effective date.

Federal Reserve Banks should distribute this letter to state member banks, bank and savings and loan holding companies (including their non-bank subsidiaries), and U.S. branches and agencies of foreign banking organizations that are engaged in mortgage servicing activities in their districts and to appropriate supervisory staff. Questions regarding this letter may be directed to:

- Jack Jennings, Senior Associate Director, at 202-452-3053, in Division of Banking Supervision and Regulation.
- Suzanne Killian, Senior Associate Director, at 202-452-2090, in the Division of Consumer and Community Affairs.

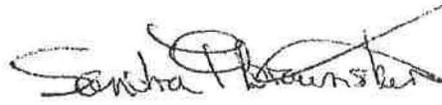
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<sup>5</sup> See 78 *Federal Register* 10696 (February 14, 2013) and 78 *Federal Register* 10902 (February 14, 2013).

In addition, questions may be sent via the Board's public website.<sup>6</sup>



Michael S. Gibson  
Director  
Division of Banking Supervision  
and Regulation



Sandra F. Braunstein  
Director  
Division of Consumer  
and Community Affairs

Attachment:

- *Minimum Standards for Prioritization and Handling Borrower Files with Imminent Foreclosure Sale*

Cross Reference to:

- CA letter 11-6, "Revised Examination Procedures for the Servicemembers Civil Relief Act"
- SR letter 07-16/CA letter 07-4, "Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages"

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<sup>6</sup> See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

**Attachment**  
**Minimum Standards for Prioritization and Handling**  
**Borrower Files with Imminent Foreclosure Sale**  
(April 23, 2013)

**Operating standards for scheduled foreclosure sales**

The minimum standards set forth in this guidance reflect sound business practices that should be part of a mortgage servicer's ongoing collections, loss mitigation and foreclosure processing functions. Accordingly, the Federal Reserve requires that all state member banks, bank and savings and loan holding companies (including their non-bank subsidiaries), and U.S. branches and agencies of foreign banking organizations that service residential mortgage loans incorporate this guidance into their ongoing business processes. Failure to comply with this guidance may result in unsafe and unsound banking practices, non-compliance with foreclosure related consent orders, as applicable, and/or require rescission of completed foreclosures.

**Purpose**

This guidance confirms the minimum standards for the handling and prioritization of borrower files that are subject to an imminent (within 60 days) scheduled foreclosure sale. The purpose of this guidance is to ensure that borrowers will not lose their homes without their files receiving, at a minimum, a pre-foreclosure sale review conducted under the standards listed in this guidance, which also help to ensure loan modifications were considered as appropriate.

Servicers of residential mortgages should use these review and validation standards to determine whether a scheduled foreclosure sale should be postponed, suspended or cancelled due to critical foreclosure defects in a borrower's file. These minimum review criteria are intended to ensure a level of consistency across servicers, not to supplant review and validation procedures that go beyond these minimums. Servicers that currently apply more than these minimum standards as part of their own pre-foreclosure sale review and validation procedures are expected to continue to do so.

These standards are not intended to incorporate the final rules amending Regulation X and Regulation Z issued by the Consumer Financial Protection Bureau (CFPB) on January 17, 2013, and effective on January 10, 2014, which govern mortgage servicers' loss mitigation and foreclosure processing functions. The Federal Reserve expects that all servicers will undertake appropriate action in a timely manner to ensure their practices will be compliant with the new rules by the effective date.

**Overview**

Servicers of residential mortgages should monitor all borrower files in the foreclosure process on at least a weekly basis to determine if a foreclosure sale is scheduled within the next 60 days. The servicer should implement procedures to perform and document a timely pre- foreclosure sale review according to the criteria set out in this guidance and appropriately postpone, suspend or cancel the scheduled foreclosure sale when warranted.

The servicer will promptly determine whether the borrower is currently in an active loss mitigation program or is being actively considered for or has requested consideration under the Home Affordable Modification Program (HAMP) or other modification or loss mitigation program as further defined in standard number 9 below, and whether further foreclosure proceedings and/or the scheduled foreclosure sale should be postponed, suspended or cancelled as required by program standards as applicable.

The following standards are a non-exhaustive list of criteria for which an exception would warrant postponement, suspension or cancellation of a foreclosure sale until the Minimum Pre-Foreclosure Sale Review Standards are satisfied. As noted above, individual servicers may apply additional standards/criteria to postpone, suspend or cancel a scheduled foreclosure sale.

Any negative response to the Minimum Pre-Foreclosure Review Standards detailed below will be considered a critical defect (except for standard number 7 where a positive response is a defect) and should cause the servicer to postpone, suspend or cancel a scheduled foreclosure sale.

Independent control functions (such as audit, compliance, and risk management) should confirm and document servicer adherence to their own servicing standards/criteria and the minimum standards in this guidance through a program of monitoring, sampling, and testing of scheduled and completed foreclosure sales.

**Minimum  
Pre-Foreclosure Sale  
Review Standards**

Date of the scheduled foreclosure sale: \_\_\_\_\_

Once the date of foreclosure is established, the servicer needs to confirm the following information before foreclosing:

1. Is the loan's default status accurate?
2. Does the servicer have and can demonstrate the appropriate legal authority to foreclose (documented assignments, note endorsements, and other necessary legal documentation, as applicable)?
3. Have required foreclosure notices or other required communications to the borrower or others, as applicable, been provided in a timely manner?
4. Has the servicer taken all steps necessary to confirm whether the borrower, co-borrower, and all obligors on the mortgage, trust deed, or other security in the nature of a mortgage are entitled to protections under the Servicemembers Civil Relief Act (SCRA), including running queries through the Department of Defense database? If the borrower, co-borrower, or other obligor is subject to SCRA protections, has the servicer complied with all applicable legal requirements to foreclose?
5. Determine whether the borrower is in an active bankruptcy. If so, does the servicer have documented legal authority to foreclose?
6. Determine whether the loan is currently under loss mitigation or other retention review or such review has been requested by the borrower as part of the foreclosure process. If so, did the servicer notify the borrower that all conditions necessary to effect the loss mitigation or retention action have not been met, what is needed to meet those conditions, and the date necessary to cure the deficiencies to avoid further foreclosure action? If a borrower submitted a complete loan modification application after the foreclosure referral, did the servicer comply with any applicable dual track restrictions?
7. Is the borrower currently in an active trial loss mitigation plan?

	<ol style="list-style-type: none"><li>8. Determine whether the servicer accepted any payment from the borrower in the preceding 60 days (that is, were borrower payments, including interest, principal, fees, or escrow payments, applied to the borrower's account or retained in a suspense account). If so, did the servicer clearly communicate to the borrower that he or she is neither in nor being considered for a loss mitigation program, and that the servicer's acceptance of the payment in no way affected the status of the foreclosure that is proceeding?</li><li>9. As applicable, was the borrower solicited for and offered a loss mitigation option, such as, those required by HAMP, government-sponsored enterprises (GSEs), Federal Housing Administration (FHA), U.S. Department of Veterans Affairs (VA), state-level government programs under U.S. Department of Treasury, other third party investor, or the servicer's loss mitigation and modification programs? To the extent applicable, has the servicer complied with its loss mitigation obligations detailed in the National Mortgage Settlement? Have any borrower complaints, appeals, or escalations been considered and addressed?</li><li>10. Was the fully executed loan modification application submitted by the borrower, as defined by the applicable modification program, and reviewed by the servicer as required, including any timeline or notice requirements?</li><li>11. Was the modification decision correct and validated as required by the applicable modification program (to include, as applicable, compliance with program requirements and accuracy of calculations and application of the net present value (NPV) test) along with appropriate resolution and communication of any borrower complaint, appeal, or escalation?</li><li>12. Was the borrower or the borrower's representative (such as, housing counselor or attorney) notified of the loan modification decision and rationale as required by the applicable loss mitigation program or these standards?</li><li>13. If required by the GSE or other investor, has the servicer certified to the attorney conducting the foreclosure that all delinquency management requirements have been met, including that there is neither an approved payment plan arrangement nor a foreclosure alternative offer pending or accepted?</li></ol>
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BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN  
DIRECTOR  
DIVISION OF CONSUMER  
AND COMMUNITY AFFAIRS

CA 11-6

August 15, 2011

**TO THE OFFICERS AND MANAGERS IN CHARGE OF CONSUMER AFFAIRS  
SECTIONS:**

**SUBJECT: Revised Examination Procedures for the Servicemembers Civil Relief Act**

This letter transmits revised examination procedures for the Servicemembers Civil Relief Act (SCRA). The SCRA provides certain financial protections to service members and, in some cases, their spouses, dependents, and other persons subject to the obligations of service members. These protections include, among other things, restrictions on interest rates contract rescissions, foreclosures, and the exercise of certain insurance policy options.

The SCRA was signed into law on December 19, 2003. The Housing and Economic Recovery Act of 2008 (HERA) amended several sections of this law by extending the availability of certain protections. Recent amendments to the HERA by The Helping Heroes Keep Their Homes Act of 2010 extended certain protections that were to expire on December 31, 2010 until December 31, 2012. In particular, the provision for an extended time period (from 90 days to nine months) for protections affecting foreclosure, sale, or seizure of real or personal property remains effective until December 31, 2012. The attached examination procedures reflect this extension.

Please distribute these procedures to your examination staff for immediate use. If you have any questions, please contact Brian Fink, Supervisory Consumer Financial Services Analyst, (202) 912-7878, or Paul Robin, Manager, Oversight and Policy, at (202) 452-3140.

Sincerely,

A handwritten signature in black ink, appearing to read "Sandra F. Braunstein", written over a horizontal line.

**Attachment: Revised Servicemember Civil Relief Act Examination Procedures**

Supersedes: CA 09-2



**BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM**

WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

DIVISION OF CONSUMER  
AND COMMUNITY AFFAIRS

SR 07 - 16 /CA 07-04

September 05, 2007

**TO THE OFFICER IN CHARGE OF SUPERVISION AND APPROPRIATE  
SUPERVISORY AND EXAMINATION STAFF AT EACH FEDERAL RESERVE  
BANK AND BANKING ORGANIZATIONS SUPERVISED BY THE FEDERAL  
RESERVE**

**SUBJECT:** Statement on loss mitigation strategies for servicers of residential mortgages

The Federal Reserve along with the other federal financial agencies and Conference of State Bank Supervisors (CSBS) issued the attached statement to encourage regulated institutions and state supervised entities that service residential mortgages (servicers) to pursue strategies to mitigate losses while preserving homeownership to the extent possible and appropriate.<sup>1</sup> The statement addresses the special issues of servicers of securitized mortgage loans that were not addressed in other recent interagency statements on residential mortgage lending.<sup>2</sup>

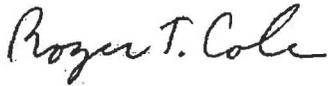
The statement outlines the steps a servicer may pursue when there is an increased risk of default, including: identifying borrowers at heightened risk of delinquency or default, contacting borrowers to assess their ability to repay, and determining whether default is reasonably foreseeable. The statement goes on to explain possible loss mitigation techniques that a servicer may pursue with a borrower. The agencies and CSBS recognize that servicers have to consider the governing documents for the securitization trust to determine their authority to restructure loans that are delinquent or are in imminent risk of default. Servicers should also consider referring appropriate borrowers to qualified homeownership counseling services that may be able to work with all parties to avoid unnecessary foreclosures.

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<sup>1</sup> For purposes of the statement, the term "federally regulated institutions" refers to state- and nationally-chartered banks and their subsidiaries; bank holding companies and their nonbank subsidiaries; savings associations and their subsidiaries; savings and loan holding companies and their subsidiaries; and credit unions.

<sup>2</sup> Refer to the October 2006 *Interagency Guidance on Nontraditional Mortgage Product Risks*, the April 2007 *Statement on Working with Mortgage Borrowers*, and the July 2007 *Statement on Subprime Mortgage Lending*.

Federal Reserve Banks are asked to distribute this letter and statement to appropriate banking organizations supervised by the Federal Reserve, as well as to their own supervisory and examination staff. For questions concerning the safety and soundness aspects of this guidance, please contact in the Division of Banking Supervision and Regulation: Sabeth Siddique, Assistant Director, at (202) 452-3861; Virginia Gibbs, Senior Supervisory Financial Analyst, at (202) 452-2521; and William Tiernay, Supervisory Financial Analyst, at (202) 872-7579. For questions related to consumer compliance issues, please contact Maryann Hunter, Advisor, Division of Consumer and Community Affairs, at (202) 452-6468.



Roger T. Cole  
Director  
Division of Banking Supervision  
and Regulation



Sandra F. Braunstein  
Director  
Division of Consumer  
and Community Affairs

*Attachment: Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages*

**Cross References:**

Interagency Guidance on Nontraditional Mortgage Product Risks (SR 06-15/CA 06-12)  
Subprime Mortgage Lenders (SR 07-12/CA 07-3)  
Working with Mortgage Borrowers (SR 07-6/CA 07-1)

## Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages

The Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, and Conference of State Bank Supervisors (CSBS) encourage federally regulated institutions<sup>1</sup> and state-supervised entities that service mortgage loans (collectively referred to as “servicers”) to pursue strategies to mitigate losses while preserving homeownership to the extent possible and appropriate.

Previously, in April 2007, the federal financial agencies issued a *Statement on Working with Mortgage Borrowers* and followed this with the July 2007 *Statement on Subprime Mortgage Lending*. Both interagency statements encouraged federally regulated institutions to work constructively with residential borrowers at risk of default and to consider prudent workout arrangements that avoid unnecessary foreclosures. In these statements, the federal financial agencies stated that prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower. CSBS, the American Association of Residential Mortgage Regulators (AARMR), and the National Association of Consumer Credit Administrators developed a parallel *Statement on Subprime Mortgage Lending* that applies to state-supervised mortgage brokers and lenders. In June 2007, CSBS and AARMR issued a consumer alert and an industry letter to address resetting mortgage loans.

These previous statements focused on residential loans retained by federally regulated institutions and state-supervised entities. However, many subprime and other mortgage loans have been transferred into securitization trusts. Servicing for these securitized loans is governed by the terms of contract documents, typically referred to as Pooling and Servicing Agreements. A significant number of adjustable-rate mortgages are scheduled to reset in the coming months. As indicated in the *Statement on Subprime Mortgage Lending* and the October 2006 *Interagency Guidance on Nontraditional Mortgage Product Risks*, these resets may result in a significant payment shock to the borrower, which can increase the likelihood of default.

Servicers of securitized mortgages should review the governing documents for the securitization trusts to determine the full extent of their authority to restructure loans that are delinquent or in default or are in imminent risk of default. The governing documents may allow servicers to proactively contact borrowers at risk of default, assess whether default is reasonably foreseeable, and, if so, apply loss mitigation strategies designed to achieve sustainable mortgage obligations. The Securities and Exchange Commission (SEC) has provided clarification that entering into loan restructurings or modifications when default is reasonably foreseeable does not preclude an institution from continuing to treat serviced mortgages as off-balance sheet exposures.<sup>2</sup> Also, the federal financial agencies and CSBS understand that the Department of

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<sup>1</sup> For purposes of this Statement, the term “federally regulated institutions” refers to state- and nationally-chartered banks and their subsidiaries; bank holding companies and their nonbank subsidiaries; savings associations and their subsidiaries; savings and loan holding companies and their subsidiaries; and credit unions.

<sup>2</sup> In general, default could be considered “reasonably foreseeable” when a lender has made actual contact with the borrower, has assessed the borrower’s ability to pay, and has a reasonable basis to conclude that the borrower will be unable to continue to make mortgage payments in the foreseeable future. See the attachment to the July 24, 2007, letter from SEC Chairman Cox to Chairman Frank, House Committee on Financial Services.

Treasury has indicated that servicers of loans in qualifying securitization vehicles may modify the terms of the loans before an actual delinquency or default when default is reasonably foreseeable, consistent with Real Estate Mortgage Investment Conduit tax rules.<sup>3</sup>

Servicers are encouraged to use the authority that they have under the governing securitization documents to take appropriate steps when an increased risk of default is identified, including:

- proactively identifying borrowers at heightened risk of delinquency or default, such as those with impending interest rate resets;
- contacting borrowers to assess their ability to repay;
- assessing whether there is a reasonable basis to conclude that default is “reasonably foreseeable”; and
- exploring, where appropriate, a loss mitigation strategy that avoids foreclosure or other actions that result in a loss of homeownership.

Loss mitigation techniques that preserve homeownership are generally less costly than foreclosure, particularly when applied before default. Prudent loss mitigation strategies may include loan modifications; deferral of payments; extension of loan maturities; conversion of adjustable-rate mortgages into fixed-rate or fully indexed, fully amortizing adjustable-rate mortgages; capitalization of delinquent amounts; or any combination of these. As one example, servicers have been converting hybrid adjustable-rate mortgages into fixed-rate loans. Where appropriate, servicers are encouraged to apply loss mitigation techniques that result in mortgage obligations that the borrower can meet in a sustained manner over the long term.

In evaluating loss mitigation techniques, servicers should consider the borrower’s ability to repay the modified obligation to final maturity according to its terms, taking into account the borrower’s total monthly housing-related payments (including principal, interest, taxes, and insurance, commonly referred to as “PITI”) as a percentage of the borrower’s gross monthly income (referred to as the debt-to-income or “DTI” ratio). Attention should also be given to the borrower’s other obligations and resources, as well as additional factors that could affect the borrower’s capacity and propensity to repay. Servicers have indicated that a borrower with a high DTI ratio is more likely to encounter difficulties in meeting mortgage obligations.

Some loan modifications or other strategies, such as a reduction or forgiveness of principal, may result in additional tax liabilities for the borrower that should be included in any assessment of the borrower’s ability to meet future obligations.

When appropriate, servicers are encouraged to refer borrowers to qualified non-profit and other homeownership counseling services and/or to government programs, such as those administered by the Federal Housing Administration, which may be able to work with all parties to avoid unnecessary foreclosures. When considering and implementing loss mitigation strategies, servicers are expected to treat consumers fairly and to adhere to all applicable legal requirements.

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<sup>3</sup> See 26 CFR 1.860G-2(b)(3)(i).



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

SANDRA F. BRAUNSTEIN  
DIRECTOR  
DIVISION OF CONSUMER  
AND COMMUNITY AFFAIRS

CA 13-7

April 25, 2013

**TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK AND TO STATE MEMBER BANKS:**

**SUBJECT: Statement on Deposit Advance Products**

**Applicability to Community Banking Organizations:** This guidance applies to all state member banks, including those with \$10 billion or less in consolidated assets.

The Federal Reserve is issuing the attached policy statement, *Statement on Deposit Advance Products*, to emphasize to state member banks the significant consumer risks associated with deposit advance products in light of the Consumer Financial Protection Bureau's April 24, 2013 white paper entitled "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings."<sup>1</sup> State member banks are expected to consider the risks associated with deposit advance products, including potential consumer harm and the potential for elevated compliance risk, when designing and offering such products.

Federal Reserve Banks are asked to distribute this letter and the accompanying guidance to state member banks, as well as to supervisory and examination staff. Questions on the attached guidance should be directed to Carol Evans, Assistant Director, at (202) 452-2051; or Amy Henderson, Managing Counsel, at (202) 452-3140. In addition, questions may be sent via the Board's public website.<sup>2</sup>

Sincerely,

A handwritten signature in cursive script, appearing to read "Sandra F. Braunstein".

Attachment: Statement on Deposit Advance Products

<sup>1</sup> [http://files.consumerfinance.gov/f/201304\\_cfpb\\_payday-dap-whitepaper.pdf](http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf)

<sup>2</sup> See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

## STATEMENT ON DEPOSIT ADVANCE PRODUCTS

The Board of Governors of the Federal Reserve System (Board) is issuing this statement to emphasize to state member banks the significant consumer risks associated with deposit advance products in light of the Consumer Financial Protection Bureau's (CFPB) April 24, 2013 white paper entitled "Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings."<sup>3</sup>

### **Background**

A deposit advance product is a type of short-term, small-dollar credit product offered by depository institutions to consumers with a deposit account or reloadable prepaid card. The depository institution allows a customer to obtain an advance on expected future deposits. Such advances and any associated fees are generally required to be repaid when the next deposit occurs.

The CFPB white paper sets forth the CFPB's initial data findings regarding the costs and patterns of deposit advance product usage by consumers. In particular, the CFPB white paper raises concerns about the significant costs associated with sustained repeat usage of deposit advance products. On April 25, 2013, the CFPB issued a press release indicating that it sees significant consumer risks and that the CFPB expects to use its full authorities to provide protections to consumers once it completes further analysis of the short-term, high-cost loan market later this spring.

### **Potential Risks Associated with Deposit Advance Products**

The Board encourages state member banks to respond to their customers' small-dollar credit needs with products that meet this demand in a responsible manner. However, state member banks should take into consideration the significant risks associated with deposit advance products, including potential consumer harm and the potential for elevated compliance risk when designing such products.

In designing and offering deposit advance products, state member banks must comply with all applicable federal laws and regulations, including but not limited to requirements under the Truth in Lending Act (TILA), the Electronic Fund Transfer Act (EFTA), the Truth in Savings Act (TISA), and the Equal Credit Opportunity Act (ECOA). In addition to these laws, institutions must act in accordance with Section 5 of the FTC Act, which prohibits unfair or deceptive acts and practices (UDAP), and Section 1036 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which prohibits unfair, deceptive, or abusive acts or practices. Depository institutions must also comply with state laws and regulations.

The prohibition against UDAP applies broadly to every stage of the deposit advance product, including marketing, servicing, and collections. The Board expects institutions to analyze the

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<sup>3</sup> [http://files.consumerfinance.gov/f/201304\\_cfpb\\_payday-dap-whitepaper.pdf](http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf)

legal risks of any deposit advance products before offering such products. The Board expects Federal Reserve examiners to thoroughly review any deposit advance products offered by supervised institutions for compliance with Section 5 of the FTC Act, as well as other applicable laws.

State member banks that rely upon outside vendors to offer deposit advance products remain responsible for compliance with applicable laws and regulations. Inadequate management or oversight of third-party vendors by depository institutions presents additional consumer and compliance risks. In addition, fee sharing or similar arrangements that create an incentive for third party vendors to increase product usage create particular risk in connection with deposit advance products given that they may lead vendors to encourage inappropriate sustained usage of such products by consumers. Accordingly, the Board expects institutions to develop procedures to closely monitor vendor practices and outcomes. State member banks should mitigate and manage such risks, consistent with applicable regulations and guidance, in connection with the design and marketing of any deposit advance products that they might offer.