FRB regulations interpreting the Equal Credit Opportunity Act.²

The FCA Board received six comment letters in response to its request for comments on the interim rule.

Comments were received from the Farm Credit Council (FCC), two Farm Credit Banks (FCBs), one agricultural credit association (ACA), the American Society of Farm Managers and Rural Appraisers, Inc. (ASFMRA), and the American Society of Appraisers (ASA).

Based upon a review of the comments received, the FCA has made a technical revision to § 614.4260(c)(5) to clarify what constitutes a "subsequent loan transaction." However, the FCA does not find it necessary to further amend the regulations as published on September 12, 1994 (59 FR 46725). The FCA does believe the comments raise some issues needing clarification, and discusses those issues in the following section-by-section analysis.

II. Section-by-Section Analysis

A. Section 614.4245—Collateral Evaluation Policies

An FCB commented that it would be appropriate to amend § 614.4245 to provide that the collateral evaluation policy adopted by an institution's board shall identify when a collateral evaluation will be required for a loan servicing transaction, but at a minimum require a collateral evaluation when a loan servicing transaction either involves the advancing of new funds, or would alter or affect the institution's collateral position.

The FCA's position is that, at a minimum, a collateral valuation will be completed on all "subsequent loan transactions," (as specified in § 614.4260(c)(5), which include but are not limited to servicing actions, reamortizations, modifications of loan terms, partial releases, etc.). Depending upon the circumstances and nature of the subsequent loan transaction and its impact upon the adequacy of the collateral, such collateral valuations may take the form of an updated report referencing previous evaluations or a more detailed evaluation. The explanatory language of the interim regulation indicated that a new real estate appraisal will be completed when there has been an advancement of new funds (including capitalizing interest) and there has been a material increase in the credit risk. If there are no new

funds advanced (other than reasonable closing costs) or, even if new funds have been advanced but there has been no material increase in the risk then a valuation may be sufficient, depending upon the institution's policies and procedures and the individual circumstances. The form and content of the valuation may range from an update, referencing previous evaluations and any changes, to a more detailed "limited" or "complete" evaluation (as defined by USPAP).

B. Section 614.4255—Independence Requirements

The FCC requested clarification that the internal control procedures may provide for post-review of credit decisions on a sampling basis. The ACA commented that the wording in this section implies that all credit decisions are either prior approved or post-reviewed, and requested that credit decisions be post-reviewed on a sampling basis.

Section 614.4255 requires the institution to have appropriate internal controls in place if they intend to use officers and employees as evaluators. The regulation refers the reader to § 618.8430 for guidance for the required internal controls. Section 618.8430 requires institutions to establish appropriate internal control policies and procedures that provide effective control over operations of the institution, including standards for collateral evaluation and scope of review selection. The regulation provides the institution the flexibility to establish the scope of the collateral and credit review (including sampling) as part of the institution's internal controls. The FCA considers a sampling of individual credit decisions to be an acceptable internal control as long as the scope of selection is sufficient to adequately identify risk in the loan portfolio.

C. Section 614.4260—Evaluation Requirements

When an appraisal by a State licensed or certified appraiser is not required, the FCC and ACA believe it would be more clear and less susceptible to misinterpretation if, "subsequent loan transaction" were defined to include specific loan servicing actions, such as reamortizations and partial releases. Similarly, an FCB believes it would be helpful if the regulation itself clearly stated that subsequent loan transactions include loan servicing transactions such as reamortizations and releases.

It is the intent of the regulations that "subsequent loan transactions" include, but are not limited to, transactions such

as renewals, reamortizations, partial releases, and modifications of loan repayment terms and maturity dates. Therefore, the FCA has made a technical change to the regulation (§ 614.4260(c)(5)) to further identify examples of "subsequent loan transactions" where a real estate appraisal may not be necessary.

Another FČB suggested that portions of FCA's explanatory comments contained in the preamble seem to be in conflict as to when an evaluation is needed on servicing actions. The FCB urges the FCA to clarify that a new evaluation is required only when new funds are advanced or there is a material increase in credit risk. The FCB also contends that requiring a collateral evaluation on all subsequent loan transactions is overly burdensome.

A similar comment has been addressed in the discussion of § 614.4245. Whenever there is a subsequent loan transaction the institution must make a determination as to the effect upon the adequacy of the collateral securing the loan as well as the impact upon the overall credit characteristics of the loan. Depending upon the circumstances, this can be accomplished through the completion of a collateral valuation or a real estate appraisal. As stated earlier, the form and content of the valuation may require nothing more than a restricted report identifying the affected collateral, references to previous evaluations, and recognition of any material changes. However, depending upon the nature of the subsequent transaction and the effect upon the collateral and the associated risk the institution may be required to provide a more detailed evaluation report ranging from a limited report to a full USPAP appraisal.

The ASFMRA was concerned that all of the Federal regulatory agencies had fashioned too broad an exception for a business loan, creating an effective "de minimis" of \$1,000,000, regardless of the purpose of the loan. The ASFMRA believes that a \$250,000 limit should apply where the purpose of the loan is for real estate acquisition or permanent

improvement.

The FCA recognizes the concern of the ASFMRA as it relates to the application of the \$1,000,000 business loan exception. However, the FCA believes that, in accordance with the March 31, 1993 Presidential directive, absent safety and soundness concerns, lenders must be afforded additional flexibility to provide credit to smalland medium-sized businesses. The Federal regulatory agencies have provided this flexibility with the \$1,000,000 exception provision. The

² The FRB published final regulations (Regulation B) on December 16, 1993 (58 FR 65657) implementing the Equal Credit Opportunity Act, 15 U.S.C. 1691–1691f, as amended by the FDIC Improvement Act of 1991, Pub. L. 102–242, 105 Stat. 2236.