

QUARTERLY REPORT

MID-SOUTH REGULATORY COMPLIANCE GROUP

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DEADLINE FOR DEVELOPMENT OF IDENTITY THEFT PREVENTION PROGRAM APPROACHING

As we have discussed in previous editions of the *Quarterly Report* and in presentations at past Quarterly Meetings, the FACT Act of 2003 and recently finalized rules under that Act require all banks to develop, implement and update a written Identity Theft Prevention Program (“ITPP”) designed to detect, prevent and mitigate identity theft in connection with “covered accounts.”

In much the same fashion as the Bank Secrecy Act Compliance Program, the ITPP is comprised of four elements:

- The identification of red flags associated with covered accounts;
- The detection of red flags that occur;
- The development of appropriate responses to red flags once detected; and
- Updates to the ITPP as risks change and new risks arise.

At the August Quarterly Meeting, we will present the members of the MRCG and MSRCG with a Generic ITPP on CD that can be modified to adapt to your bank’s unique situation. While many parts will be very similar for all banks, obviously each bank’s own experience with identity theft and each bank’s unique mix of products and services will necessitate a significant amount of work to finalize the draft policy. The balance of this article is devoted to the steps your bank will need to take to finalize your own ITPP.

Again, similar to your Bank Secrecy Act Compliance Program, your ITPP requires both an initial Risk Assessment for the risk of identity theft and periodic reviews of that Risk Assessment. The first step in performing that

initial Risk Assessment is a base inventory of the bank’s lines of business and the types of products and services that the bank offers within those lines of business.

Because each bank must perform its own Risk Assessment and its own inventory of business lines by product and services, we have drafted that part of the ITPP as an exhibit to the ITPP and as a spreadsheet that can be expanded to encompass a variety of lines of business, products and services, controls, red flags, responses, etc.

Although no one has significant experience in the development of an effective Risk Assessment for the ITPP, several helpful points have emerged.

First, the Risk Assessment for ITPP purposes and the Risk Assessment for BSA purposes cover virtually the same list of business lines, products and services. And each of these Risk Assessments requires periodic updating. It should be possible to kill two birds with one stone when performing these updates.

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Second, it may be possible to exclude certain products and services from the ITPP by either determining that they do not meet the definition of a "covered account" (see earlier *Quarterly Reports*) or pose virtually no risks of identity theft.

Next, it may be possible to lump a number of similar products into a single category for consideration and analysis of those products, e.g., consumer deposit accounts, which feature many of the same characteristics, risks for identity theft and responses when a red flag is detected.

Also, it may be helpful to address the two separate types of identity theft risk exposure (i.e., account opening risk and account maintenance risk) as separate policy considerations for each identified category of product or service.

The risks for opening a covered account and the risks for maintaining a covered account will need to be treated separately, with each of the other elements of the ITPP taken into account in each instance. For instance, the bank must consider the risks associated with opening deposit accounts. It then must take into account the controls that are already in place to detect red flags associated with that activity (e.g., the bank's CIP procedures). The bank must then list the applicable red flags that it has identified for that particular risk factor (e.g., unable to verify identity using CIP), and list the various possible responses to the red flag detected (e.g., perform further investigation, or refuse to open account).

These considerations of individual risk factors, existing controls, existing red flags, and possible responses, when displayed in spreadsheet fashion and attached to an exhibit to the ITPP can then be expanded, modified, etc., to take into account future experience with identity theft, additional regulatory guidance, development of new products and services, and changes in business model (mergers, etc.).

Two additional aspects of the FACT Act Red Flags Guidelines will also need to be taken into account. In particular, the risks of identity theft associated with the receipt of a change in address notice, followed closely (e.g., within 30

days) by a request for a new card or access device should constitute a red flag and trigger an appropriate response which would include investigating the authenticity of the request for change of address and/or new card and a list of possible responses which could range from the issuance of a new card to the refusal to do so and possible closing of the account. Since this is a separate aspect of the Red Flags Guidelines, and yet falls within the scope of the ITPP, particular attention should be paid to that particular red flag in order to demonstrate compliance with that separate, but related, requirement.

Finally, procedures need to be developed in order to detect an address discrepancy between the address provided on an application and the address contained in a credit bureau report. While the existence of such a discrepancy constitutes a red flag and could occur in any instance where a credit bureau report of any type is utilized (loans, deposit accounts, etc.), the detection of such a discrepancy, the resolution of the discrepancy and the reporting back to the credit bureau of the correct address also are separate requirements under the Red Flags Guidelines. Therefore, address discrepancy in a credit bureau report would constitute a red flag, but it will not be sufficient to simply resolve the discrepancy and take the appropriate response. In addition, the bank must have procedures for promptly reporting back to the credit bureau the results of the address discrepancy resolution. We plan to have an in-depth discussion of these last two requirements as a follow-up to the presentation of the ITPP at the August Quarterly Meeting.

With the November 1, 2008 deadline for development of the ITPP looming, much needs to be done. Please feel free to bring other persons associated with your ITPP development efforts to the Quarterly Meeting if you feel they would benefit from this discussion.

<Ed Wilmesherr>

TRUTH-IN-LENDING/ HOEPA RULES FINAL

In the February issue, we discussed the proposed Truth-in-Lending /HOEPA rules issued earlier by the Federal Reserve Board. The Fed has broad authority under the Home Ownership and Equity Protection Act (“HOEPA”) to prohibit unfair or deceptive practices in connection with mortgage loans and to prohibit abusive practices, or practices not in the interest of borrowers, in connection with refinancings. In January, it proposed significant changes to Regulation Z which would create special rules for “higher priced mortgage loans,” add additional consumer protections for all mortgage loans secured by a consumer’s principal dwelling and impose new requirements for advertising dwelling secured credit.

The Board received approximately 4,700 comments on the proposal from a wide variety of sources including community banks, large bank holding companies, independent mortgage companies, credit unions, mortgage brokers, realtors, trade associations, consumers and consumer advocacy groups. Many of you commented using the draft comment letter we prepared for compliance group members. The comments from the banking and mortgage industry were only partly successful in persuading the Fed to make changes to the proposed regulations. Unfortunately, the most burdensome requirement – mandatory escrows for taxes and insurance on first lien higher priced mortgage loans – remains in the final rules, although the Fed did approve a change in the definition of what constitutes a higher priced loan which may exclude some loans from coverage.

As a rationale for approval of these significant changes, the Fed cites serious concerns about the mortgage market including large increases in the volume of delinquencies and foreclosures in both sub-prime and Alt. A, or near prime, loans. According to studies cited, the proportion of all sub-prime mortgages past due 90 days or more tripled from 2005 to 2008. The risk of serious delinquency for near prime loans rose from less

than 2% to over 8% in the course of a single year. Lenders initiated over 550,000 foreclosures in the first quarter of 2008, nearly twice the quarterly average for the past six years. The Fed attributes the rise in delinquencies to a decline in house price appreciation and a loosening of underwriting standards and believes that the loosening of underwriting standards is the result of what it calls “market imperfections.” These market imperfections include lack of price and product transparency compounded by misleading or inaccurate advertising which make it harder for consumers to protect themselves even with the best disclosures.

According to the Fed, while loan price information is widely available to the public in the prime mortgage market, sub-prime rates are not readily available and often may be obtained only after the consumer applies for a loan and pays a fee. As a result, it may not be apparent to consumers that shopping around may produce better loan terms. Shopping around for a better deal may also require additional applications and payment of additional fees. The role of mortgage brokers compounds the issue as consumers tend to believe that a broker is obligated to find the best terms for them. Consumers often don’t understand that a broker may receive higher compensation for a loan with an interest rate higher than what the borrower might otherwise qualify for.

Sub-prime loan products also tend to be more complex and less standardized than prime loans. Consumers are more likely to focus on those features of the loan that seem more important to them such as loan amount, down payment amount, initial monthly payment, initial interest rate and up front fees. They may be less likely to focus on items such as future increases in the payment amount or interest rate, future tax and insurance obligations and prepayment penalties. Obtaining widespread consumer understanding of the many significant features of the typical sub-prime loan is a major challenge. Consumers who do not fully understand the terms and features are less able to appreciate the risks. Once the consequences become apparent, prepayment penalties may prevent consumers

from refinancing on more favorable terms. According to the Fed, further disclosures may not be sufficient to educate consumers or protect them against unfair loans terms or lending practices.

The Fed's stated goals in adopting the final regulation are: to protect consumers in the mortgage market from unfair, abusive or deceptive lending and servicing practices while preserving responsible lending and sustainable home ownership; insure that advertisements for mortgage loans provide accurate and balanced information without misleading or deceptive representations; and to provide consumers with transaction specific disclosures early enough to use while shopping for a mortgage. The final rules attempt to meet those goals by: providing protections for a new category of loans called "higher priced mortgage loans" secured by a consumer's principal dwelling; adding new protections for all mortgage loans secured by a consumer's principal dwelling; requiring advertisements for dwelling secured credit to provide accurate and balanced information, in a clear and conspicuous manner, about rates, monthly payments, and other loan features and banning a laundry list of deceptive or misleading advertising practices; and finally, by requiring creditors to provide consumers with transaction specific mortgage loan disclosures within 3 business days after application and before they pay any fee, except a reasonable fee for reviewing credit history.

Higher Priced Mortgage Loans. Current Reg. Z provisions under HOEPA place restrictions on "high cost loans" secured by a consumer's principal dwelling with high cost being defined by reference to the interest rate and/or fees charged on the loan. The existing Reg. Z requirements for high cost loans remain in effect. The new HOEPA regulations will add a whole new category of mortgage loans called "higher priced mortgage loans" which will be defined by reference to a new interest rate index to be published by the Federal Reserve.

A higher priced mortgage loan is a consumer loan secured by the consumer's principal dwelling with an annual percentage rate that

exceeds the "average prime offer rate" for a comparable transaction as of the date the interest rate is set by 1.5% for a loan secured by a first lien or by 3.5% for a loan secured by a subordinate lien. The Federal Reserve will determine the "average prime offer rate" based on a survey currently published by Freddie Mac and will publish the average prime offer rates for a variety of transactions and maturities in a table updated at least weekly. Exempt from the definition of higher priced mortgage loan are transactions to finance initial construction of a dwelling, a temporary or bridge loan with a term of 12 months or less, a reverse mortgage transaction, or a home equity line of credit. The Fed also issued a proposed change to Regulation C which would conform the requirements for reporting rate spread loans on the HMDA LAR to the new definition of higher priced mortgage loans.

Consumer Protections for Higher Priced Loans.

The final rule will add new protections for consumers in connection with higher priced mortgage loans. First, the lender is prohibited from making a higher priced mortgage loan based on collateral value without regard to the borrower's ability to repay the loan from income and assets other than the home's value. A lender will be required to verify the consumer's repayment ability including the consumer's current and reasonably expected income, employment, assets other than the collateral, current obligations, and mortgage-related obligations. Verification of income and assets may be by W-2, tax returns, payroll receipts, financial institution records or other third party documents that provide reasonably reliable evidence of the consumer's income or assets. The term "mortgage related obligations" refers to expected property taxes, premiums for mortgage related insurance and similar expenses.

The existing HOEPA/Regulation Z requirements already prohibit making a high cost loan based on collateral value without regard to the consumer's ability to pay, but require a borrower to demonstrate a pattern or practice in order to prove a violation. Under the new rules, the pattern or practice requirement will be eliminated for both high cost and higher priced

mortgage loans so a single incident may result in a violation. However, a safe harbor is provided for satisfying the new verification requirements. A lender will be presumed to have complied if it verifies the consumer's income and assets to be relied upon and determines repayment ability using the largest payment of principal and interest expected in the first 7 years of the loan, taking into account current and mortgage related obligations, and using either debt to income or remaining income after paying debt obligations as a means of assessing repayment ability. No presumption of compliance is available for a transaction which could include the possibility of negative amortization or a balloon payment within the first 7 years.

Second, prepayment penalties are restricted on higher priced mortgage loans. Prepayment penalties are totally banned if the payment on the loan can change at any time during the first 4 years of the loan. For other higher priced mortgage loans, a prepayment penalty cannot last for more than 2 years and may not be imposed if the source of the prepayment is a refinancing by the same lender or an affiliate of the lender.

The third and most controversial of the new requirements is mandatory escrow accounts for payment of property taxes and insurance for first lien higher priced mortgage loans. The lender or servicer has the option of permitting a consumer to cancel the escrow account upon the consumer's written request after 1 year. Insurance premiums for condominium units where the condominium association has an obligation to maintain a master policy need not be included. The rules also prohibit a creditor from structuring a home secured loan as an open-end credit plan in order to evade the escrow requirements.

New Protections for all Principal Dwelling Secured Mortgages. The final rules will prohibit certain practices by servicers of mortgage loans deemed unfair by the Fed. Prohibited practices include failing to credit a payment to a consumer's loan account as of the date of receipt (except where a delay in crediting does not result in any late fee or other charge to the

consumer or in the reporting of negative information to a credit bureau). A servicer may impose specific requirements in writing for a consumer to follow in making payments, such as by requiring payments be mailed to a particular address. Any payments that do not conform to the specified requirements must be credited within 5 days after receipt.

Servicers will also be prohibited from pyramiding late charges. No late fee or delinquency charge may be imposed with respect to a payment when the only delinquency is attributable to late fees or delinquency charges assessed on an earlier payment, and the payment is otherwise a full payment for the particular payment period and is made on time or within any applicable grace period.

In addition, servicers will be required to provide a pay-off statement within a reasonable period of time after receiving a request from the consumer or any person acting on behalf of the consumer. The statement must include the total outstanding balance that would be required to satisfy the consumer's obligation in full as of a specified date.

Under the new regs, a creditor or mortgage broker or any affiliate will be expressly prohibited from directly or indirectly coercing, influencing or otherwise encouraging an appraiser to misstate or misrepresent the value of a dwelling. Examples of actions that would violate the prohibition are listed in the final rules and include implying that present or future use of the appraiser may depend on the value the appraiser gives the dwelling, excluding an appraiser from future work because the value of the dwelling does not meet a minimum level, telling an appraiser that a certain minimum value is needed in order to approve the consumer's loan, failing to compensate an appraiser because the value is not above a certain amount, or conditioning the appraiser's compensation on consummation of the loan. Examples of actions that would not violate the prohibition include asking the appraiser to consider additional information about the dwelling or comparable properties, requesting the appraiser to provide additional information about the basis for the

valuation, requesting an appraiser to correct factual errors in a valuation, obtaining multiple appraisals as long as the creditor follows a policy of using the most reliable appraisal rather than the appraisal with the highest value, withholding compensation from the appraiser for breach of contract or substandard performance of services as provided by contract, and taking other action that is permitted or required by applicable federal or state law. A creditor who knows of a violation is prohibited from extending credit based on the appraisal unless the creditor also documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the dwelling's value.

Finally, lenders will be required to provide a good faith estimate of loan costs, including a schedule of payments, within 3 days after receiving an application for a loan secured by a consumer's principal dwelling. Existing Reg. Z early disclosure requirements apply to a residential mortgage transaction to finance acquisition or initial construction of a dwelling. The new regulations will extend this requirement to all loans subject to RESPA secured by the consumer's principal dwelling other than a home equity line of credit. This will extend the early disclosure requirements to cover closed-end, principal dwelling secured home improvement and home equity loans and refinances. No fee may be imposed on the consumer prior to receipt of the early disclosures other than a credit report fee that is bona fide and reasonable in amount.

Advertising Requirements. The final regulations will require that advertisements for both open-end and closed-end dwelling secured loans provide accurate and balanced information in a clear and conspicuous manner about rates, monthly payments and other loan features. New requirements will apply to advertisements of home equity plans concerning discounted or promotional rates and payment terms and balloon payments. A number of additional disclosures will be required for advertising of closed-end dwelling secured loans with respect to variable rates and payment amounts. Required disclosures in advertisements will

generally have to satisfy the clear and conspicuous standard.

The new rules will also prohibit seven specific practices in advertisements for closed-end mortgage loans deemed to be deceptive or misleading. These include:

- Advertising "fixed" rates or payment amounts where rates or payments can vary without adequately disclosing that the interest rate or payment amount is fixed only for a limited period of time rather than for the full term of the loan;
- Comparing an actual or hypothetical rate or payment amount with any rate or payment amount that will be available under the advertised loan for less than the full term of the loan unless the advertisement also discloses the rates or payments that will apply over the full term;
- Advertisements characterizing a product as a "government loan program," "government-supported loan" or otherwise endorsed or sponsored by a governmental entity unless the ad is for an FHA, VA or other loan that is actually endorsed or sponsored by a government entity;
- Advertisements, including solicitation letters, that use the name of the consumer's current mortgage lender unless it also prominently discloses the name of the person making the solicitation and states clearly and conspicuously that the person making the advertisement is not affiliated with the current lender;
- Any misleading claim about debt elimination (for example, advertising claims of debt elimination if the loan product would merely replace one loan with another);
- Using the term "counselor" in connection with a for-profit mortgage broker;
- Providing some information, such as a low introductory "teaser" rate or payment amount, in a foreign language while

required disclosures are provided only in English.

Yield Spread Premiums. The Board withdrew its proposed rule regarding yield spread premiums. That proposal would have prohibited lenders from compensating mortgage brokers through yield spread premiums unless the broker previously entered into a written agreement with the consumer disclosing the broker's total compensation along with other information.

Effective Dates. Compliance with the new rules, other than the escrow requirement, is mandatory for all applications received on or after October 1, 2009. The escrow requirement is phased in over a longer period of time and has an effective date of April 1, 2010 for site built homes and October 1, 2010 for manufactured homes.

Liability. Like the existing Reg. Z/HOEPA regulations covering high cost loans, these new requirements will carry a significant risk of liability for non-compliance. The Fed is relying on Section 129(l) of the Truth-in-Lending Act, added by HOEPA, as its authority for issuing the new regulations. Under the civil liability provisions of TILA, a violation of Section 129 gives rise to liability for an amount equal to all finance charges and fees paid by the consumer in addition to actual damages, the statutory penalty amount and attorneys fees.

These new rules will require major changes for many lenders. While many banks made an effort to avoid making HOEPA loans under the existing rules, it seems unlikely that any bank will be able to totally avoid making higher priced mortgage loans meaning they will be forced to put systems, procedures and staff in place to handle escrow accounts for at least those loans. Some may find it easier to cover most or all first lien loans rather than trying to segregate higher priced mortgage loans and risk overlooking one. Underwriting and documentation requirements will also need to be looked at and, possibly, overhauled, particularly concerning income and asset verification. New early disclosures will need to be developed. Prepayment penalties will need to be revisited. And, it will be more important than ever for

home loan advertising to be reviewed and approved in advance by the compliance officer.

<Cliff Harrison>

FDIC ADDRESSES BEST PRACTICES FOR REDUCING OR SUSPENDING HOME EQUITY LINES OF CREDIT

In June the FDIC published Financial Institution Letter FIL-58-2008, on the topic of consumer protection, risk management, and suggested best practices for financial institutions when reducing or suspending home equity lines of credit. The significant decline in home values in many regions of the country has posed a potential problem by lowering the value of underlying collateral for home equity lines of credit (HELOCS), particularly in the regions that have been hardest hit by lower home prices. The FDIC notes that this phenomenon may potentially increase the overall risk of HELOCS for certain institutions, and create situations in which more financial institutions may consider taking actions to mitigate risk on existing HELOCS. Specifically, the FDIC recommends that guidance detailed in the May, 2005 *Interagency Credit Risk Management Guidance for Home Equity Lending*, and its October, 2006 *Addendum* be reviewed by institutions that may be subject to the sharply declining housing markets.

Truth In Lending Requirements. There are avenues that, when used appropriately, allow institutions to reduce credit limits or suspend HELOC availability under certain circumstances, but it is important to conform to the requirements of Regulation Z and to be sure that the process of reducing or suspending a HELOC credit line does not operate in a discriminatory manner or in violation of Federal Trade Commission laws and regulations prohibiting unfair and deceptive practices.

Regulation Z, in 12 CFR 226.5b(f)(3)(vi)(A), states that a lender may reduce the applicable credit limit, or prohibit additional extensions of credit for a HELOC, "during a period in which

the value of the dwelling that secures the plan declines significantly below the dwelling's appraised value for purposes of the plan." The lender is required to support its determination that such a "significant decline" has occurred, and there are no defined, objective standards in the regulation to assist in measuring a "significant decline." The Official Commentary suggests that circumstances largely determine the amount of decline in value that would constitute "significant decline," but then goes on to cite an example that such a decline may be considered to have occurred if unencumbered equity declines by at least 50 percent. In any event, the financial institution must have a "sound factual basis" for asserting a significant decline in value as a basis for reducing line availability or suspending a line. While an appraisal is not required, information such as tax valuation or automated valuation models may be used as evidence of a value decline.

Regulation Z cites another basis, in 12 CFR 226.5b(f)(3)(vi)(B), for reducing or suspending credit limits if the "creditor reasonably believes that the consumer will be unable to fulfill the repayment obligations under the plan because of a material change in the consumer's financial circumstances." In order for this to serve as a basis for reducing or suspending a credit limit, there must be evidence of a material change in financial circumstances, for example, a significant decrease in the consumer's income. Further, the lender must have a reasonable belief that, as a result of the material change, the consumer will not be able to meet his or her repayment obligations. Finally the lender must have a factual basis for any actions taken concerning a HELOC on the basis of a material change in financial circumstances, and the lender may use different sources of specific evidence, such as failure to pay other debts, in order to establish the necessary factual basis.

Notice must be given to the consumer if the credit limit on a HELOC is suspended or reduced, within three business days after the action is taken. The notice must contain specific reasons for the action, and should explain whether (a) the consumer must request reinstatement of the original credit limit, or, if

not, (b) the lender must monitor the line to determine whether the conditions causing the reduction or suspension no longer exist. If such conditions no longer exist, the lender must reinstate the privileges under the HELOC as soon as reasonably possible.

HELOC limits may also be reduced or suspended in the following events:

- the borrower is in default under the agreement;
- the lender cannot impose the APR provided in the agreement due to government action;
- an adverse effect on the lender's security interest resulting from government action, such that the value is less than 120 percent of the credit line;
- the lender is notified by regulatory authorities that continued advances on the HELOC constitute an unsafe and unsound practice.

Other Regulatory Considerations; Best Practices. As previously stated, taking action to reduce or suspend HELOC limits based on a substantial decline in collateral value or a material change in financial circumstances may involve subjective judgment of surrounding facts and circumstances – just as encountered in originating a loan. For this reason, institutions must ensure that their practices in making judgments related to reducing or suspending HELOCs do not discriminate on the basis of race, sex, or other factors specified in the Equal Credit Opportunity Act and Regulation B, or the Fair Housing Act. If an institution finds that HELOC reductions/suspensions may become widespread in its portfolio, a written policy should be implemented that accounts for identifying sound factual circumstances that may prompt such actions and ensure that policies are applied consistently for all borrowers – without regard to prohibited factors. The policy must also be consistently applied within particular geographic areas. Lenders should ensure that Federal Trade Commission laws and regulations prohibiting unfair and deceptive acts and practices are not violated in the process of the reduction or suspension of HELOC credit limits.

The FDIC strongly urges, as a matter of best practices, that lenders take actions to work with borrowers who may face financial hardship or special inconveniences from the consequences of having a HELOC line reduced or suspended. The FIL specifically mentions examples of such situations as small business owners who may use HELOCS to finance business needs, or consumers who may have existing home improvement projects in process. Other actions that may be warranted in order to work with consumers could include offering other, non-home secured financing if the borrower is otherwise financially sound, and providing the borrower an opportunity to request a review of the decision to reduce or suspend the line. In such a situation the borrower may be able to present additional evidence that tends to mitigate the risk on which the original decision by the lender was based.

With the housing market likely to continue in a state of flux for the foreseeable future, many banks should review this guidance and if needed implement appropriate policies to address the proper handling of HELOC credit limit reduction or suspension.

<Virginia Wilson>

CONGRESS PASSES MAJOR HOUSING BILL

On Saturday, July 27, 2008, the Senate passed H.R. 3221, the Housing and Economic Recovery Act of 2008. The House had previously approved the Bill on July 23, 2008. President Bush signed the Bill into law on July 30, 2008.

Reminiscent of what were referred to in the 80's as "Christmas Tree" legislation, this Bill has numerous riders and attachments that thus far, have not received much attention. While the major thrust of the legislation could be beneficial, certain of its provisions could create problems that we have not had an opportunity to consider yet. There is not sufficient time before needing to print this addition of the *Quarterly Report* to provide more than a very brief

summary of certain of these provisions. Listed below are only some of the more significant issues that will affect banks and their mortgage company or mortgage division activities.

Mortgage Broker and Originator Licensing.

The Bill requires licensing and registration for all loan originators, including mortgage brokers and loan officers, utilizing a nationwide system. All loan originators at federally-regulated banks and other institutions must register through this nationwide system. States are permitted to develop a license system; however, if a state fails to do so within twelve months HUD is directed to establish a licensing system for that state.

FHA Expansion. HUD's Federal Housing Administration is given additional flexibility to insure more mortgages. Homeowners who qualify, but cannot afford their current mortgages, will be allowed to refinance into a more stable and affordable 30-year loan backed by the federal government. The Act establishes eligibility criteria for borrowers, and requires FHA lenders to write-off a significant portion of the debt. Borrowers must share any new equity that results from the write-off in future appreciation with FHA. This program is temporary and begins on October 1, 2008, with a sunset provision on September 30, 2011.

Foreclosure Prevention Act of 2008. This Act contains the following provisions.

- **FHA Modernization.** The FHA loan program is expanded and modernized to increase FHA's lending authority from 95% to 115% of area median home price with a cap of 150% of GSE limit (currently, \$625,500), allowing expanded access to homeownership.
- **Community Assistance.** The Bill includes \$3.92 billion for the hardest hit communities to deal with the problem of foreclosed, unoccupied houses. This program will take the form of a Community Development Block Grant that will be used to purchase foreclosed homes at a discount and rehab

those homes to stabilize neighbors and stem significant losses to neighboring properties.

- Pre-Foreclosure Counseling. The Bill provides \$150 million in additional funding for housing counseling. These funds will be distributed by the Neighborhood Reinvestment Corporation by the end of 2008. Additionally, \$30 million is provided in this legislation to provide legal services to distressed borrowers.
- Enhanced Mortgage Disclosures. Coincidental with changes made to Regulation Z under the HOEPA regulations, the Truth-in-Lending Act ("TILA") is amended to expand the types of loans subject to early disclosures (within three days of application) under TILA to include all mortgages, including refinance and home equity loans. The Bill requires that disclosures be provided no later than seven days prior to closing to allow borrowers to shop for another loan if dissatisfied with the terms. A new disclosure form is required which informs borrowers of the maximum monthly payments possible under their loan, and the statutory damages for violations of TILA is raised to \$4,000.
- Foreclosure Assistance for Veterans. The Bill lengthens the time a lender must wait before starting foreclosure from three months to nine months after a soldier returns from service and also provides returning soldiers with one year relief from increases in mortgage interest. The VA loan guarantee amount is also increased.

This legislation has been widely discussed and publicized, but the details have not. We will include a summary discussion of this legislation as a part of the agenda for the August Quarterly Meeting. Due to the significance of this legislation, it will undoubtedly be a topic for a number of Quarterly Meetings to come.

<Ed Wilmesherr>

FEDERAL RESERVE PROPOSED REGULATIONS ON OVERDRAFT PROTECTION

On May 2, 2008, the Federal Reserve issued a press release concerning proposed amendments to Regulation AA (Unfair or Deceptive Acts or Practices), Regulation Z (Truth In Lending), and Regulation DD (Truth In Savings), that are designed to address specific problems in credit card interest charges and billing practices and in overdraft protection plans. These proposed rule changes are being simultaneously issued under the Federal Trade Commission Act, and the Truth In Lending and Truth In Savings laws and related regulations.

The major thrust of the proposed regulations is directed to credit card practices, particularly related to handling interest charges, but another area addressed in the proposal concerns overdraft programs and related practices of financial institutions in connection with those programs. The new rules would prohibit unfair acts or practices related to overdraft services for consumer deposit accounts. The intent of the rules is to assure that consumers understand overdraft services and have an opportunity to opt out of such services.

The proposed rule states that it is an unfair act or practice for an institution to assess a fee or charge on a consumer's account for paying an overdraft unless the institution provides the consumer with the right to opt out of the overdraft payment service and a reasonable opportunity for the consumer to exercise the right to opt out. If the consumer does not opt out, then the fee or charge may be assessed. The financial institution providing the consumer notice of the right to opt out of overdraft payment services must comply with a consumer's opt out request as soon as reasonably practicable after receipt.

The consumer may opt out of overdraft payment by the institution at any time, in other words, the right to opt out does not expire after a period of time following a notice. Additionally, the consumer must receive notice of the right to opt

out at least once for any periodic statement cycle in which a fee or charge for paying an overdraft is assessed, provided that the consumer has not already opted out. The right to opt out applies to all transactions that may overdraw an account, including ACH transactions, ATM transactions, debit cards, or checks. The consumer may only partially opt out of charges related to overdrafts caused by certain transactions. For example, a consumer may opt out of the payment of overdrafts only if caused by ATM withdrawals or debit card, point-of-sale transactions. Any election by the consumer to opt out is effective until revoked by the consumer.

There are two exceptions that would permit an institution to charge a consumer's account related to an overdraft, even if the consumer has opted out. These situations apply to debit card transactions as follows:

- If a consumer's account contained sufficient funds at the time the authorization request was received for the debit card transaction, but the actual purchase amount for that transaction exceeds the amount that had been authorized; or
- If the transaction is presented to the institution for payment by paper-based means, rather than through a card terminal, and the institution has not previously authorized the transaction.

Finally, the new rules provide that a financial institution may not assess a fee or charge on a consumer's account for an overdraft service if the overdraft occurred due to a hold in place on funds in the consumer's account that is in excess of the actual purchase or transaction amount.

These rules as described have been in the comment period, and have not been finalized as of this writing. The notice and opt-out rules and associated recordkeeping will be very burdensome on institutions that offer overdraft protection programs, and hopefully these

concerns will be reflected in the comments, and taken into account in the final form of the regulations.

<Virginia Wilson>

MSRCG QUARTERLY MEETING TO BE HELD ON AUGUST 26, 2008

The MSRCG will hold its Quarterly Meeting on Tuesday, August 26, 2008, at the Racquet Club of Memphis located at 5111 Sanderlin Avenue, Memphis, Tennessee. Registration will begin at 9:30 a.m. with our meeting presentation beginning promptly at 10:00 a.m..

The Quarterly Meeting will feature the presentation and discussion of the draft Identity Theft Prevention Program Policy which must be finalized and implemented by November 1, 2008. Separate discussions devoted to the FACT Act changes related to address discrepancies in credit bureau reports and change of address requests that are followed by requests for new access devices will take place. A summary of the recently finalized HOEPA regulations will also take place, and other presentations will cover the regulatory requirements for modifying HELOC accounts, change to flood insurance interpretations and more. Time permitting, a summary of the recently enacted housing legislation will be included. The lunch hour will provide the usual summary of recent regulatory developments.

As always, the dress code for this occasion is casual, and lunch will be provided. We ask that you fax or e-mail your registration form enclosed with this copy of the *Quarterly Report* to Liz Crabtree no later than **August 14, 2008**, so that arrangements for lunch can be finalized. We look forward to seeing you there.

<Ed Wilmesherr>

MSRCG COMPLIANCE CALENDAR

1/31/05 - Revised FACT Act Notices Effective	11/1/06 - EPA All Appropriate Inquiries Rule Effective
3/29/05 - Effective Date for Interagency Guidance on Response Programs for Unauthorized Access to Customer Information	1/1/07 - Mandatory compliance date for Reg. E changes on electronic check conversions, payroll card accounts and ATM surcharge disclosures
4/8/05 - Effective date for OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices	7/1/07 - Reg. E payroll card account provisions effective
4/26/05 - Joint Guidance on Banking Services to MSB's Issued	10/01/07 - National Defense Authorization Act Usury Provisions Effective
7/1/05 - Final Rule on Disposal of Consumer Information (FACT Act) effective	1/1/08 - FACT Act Affiliate Marketing Rule Effective
7/1/05 - Effective Date for Joint Guidelines for Disposal of Consumer Information	8/26/08 - MSRCG August Quarterly Meeting
8/1/05 -Disclosures re: Opt Out Rights for Credit Or Insurance (FACT Act) Final	9/16/08 - MSRCG Steering Committee Meeting
9/01/05 - CRA Final Rule Becomes Effective	10/1/08 - FACT Act Affiliate Marketing Rule Mandatory Compliance Deadline
2/13/06 - OFAC Guidelines Effective	10/1/08 - Electronic Disclosure Regulation effective
4/1/06 - Deposit insurance limits on retirement accounts increased to \$250,000	11/1/08 - Red Flag Guidelines compliance mandatory
4/1/06 - Effective date for FACT Act regulations on use of medical information in determining credit eligibility	11/18/08 - MSRCG November Annual Meeting
6/30/06 - Effective Date for use of new SFHD forms	10/1/09 - HOEPA Regulations changes generally effective
7/1/06 - Reg. DD Amendments on Overdraft Privilege Plans Effective	4/1/10 - Escrow requirements effective for site-built homes
7/1/06 - Effective date for Reg. CC amendments on remotely created checks	10/1/10 - Escrow requirements effective for mobile homes

<Ed Wilmesherr>