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Quarterly Report

Mississippi Regulatory Compliance Group

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GOOD NEWS ON FAIR LENDING

Fair Lending continues to be a focal point for the federal bank regulators and with the CFPB. And it continues to be a source of concern for banks of all sizes. The CFPB in particular has pursued to settlement a number of Fair Lending enforcement actions, resulting in significant payments to those customers that were alleged to have been discriminated against and significant expense to the banks involved in the form of legal fees, restitution and compliance monitoring costs. But have these enforcement actions resulted in real benefit to the borrowing public? Some argue that the answer is "No."

Nixon State Bank is a case in point. Nixon State Bank was an $80 million bank that entered into a settlement agreement with the Department of Justice (DOJ) on June 17, 2011, agreeing to pay approximately $100,000 in restitution and penalties in response to allegations that it priced loans to Hispanic borrowers higher than loans to non-Hispanic borrowers.

Nixon had made almost $8,000,000 in unsecured loans in denominations under $500, as the regulators had encouraged banks to do. It was this book of loans that drew the criticism.

At first glance, these loans did not appear problematic. The highest interest rate was 10%. And yet using regression analysis and a disparate impact theory of discrimination, the DOJ was able to bring Nixon to the settlement table. The expense of litigating with the DOJ was just too great.

Some identified customers received compensation, and penalties were paid to the various regulatory agencies. But the real impact of the settlement can only be seen in hindsight. Nixon has reduced its volume of small loans by 50%. The average interest rate on these loans has almost doubled to compensate for increased enforcement risk and risk of default. And, related or not, Nixon has made a decision to sell itself to one of its competitors.

While the use of the disparate impact theory of pricing discrimination remains controversial, the CFPB in particular has reaffirmed its position that these type cases will be pursued. That policy decision creates loan pricing issues for all lenders.

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As you know, disparate impact discrimination occurs when you employ a policy that is neutral on its face with respect to discrimination, but in effect impacts members of protected classes (females, minorities, etc.) in a disproportionate way. The issue of loan pricing can be especially susceptible to this kind of analysis.

Now, to some good news.

I think by now almost all of you know Brandon Roberts and his company, Premier Insights. Many of you have used Brandon's services for Fair Lending, CRA and HMDA analysis. Brandon also took part in our Fair Lending Initiative three years ago, handling the portion of that project related to the use of regression analyses to review HMDA data reporting results.

Drawing off of his experience, and with the help of Butler Snow LLP, Brandon has now developed a prototype loan pricing and underwriting product designed to manage consumer loan pricing and underwriting issues. This product is designed for community banks and is centered on two core objectives: (1) effectively managing Fair Lending risks at a lower cost by leveraging objective policy with technology; and (2) implementing a manageable and profitable underwriting and pricing strategy based on relevant, objective criteria.

Testing for this product began in 2013. Real time testing began in January of this year at one of our community bank clients. The results have been excellent. In addition to managing Fair Lending risks with more confidence, the bank has been able to improve its interest rate margin over previous operating results while remaining confident that it is objectively managing its underwriting in an unbiased and non-discriminatory manner.

Brandon describes this product as "a scaleable and customizable, web-based loan application and origination system," one that is easily deployed and managed because it operates from the secure servers at Premier Insights. As a result, there is no hardware to buy and only a simple web browser is needed to operate the platform.

As with any new innovation, it is impossible to say with certainty how the regulators will react, but it seems clear that more objectivity in underwriting and pricing, and less subjectivity on the part of individual underwriters, should be viewed as a good thing. Disparate impact discrimination rests with the unintended consequences of policies that appear neutral on their face. The more uniformity and objectivity that can be built into a loan pricing and underwriting system, the better.

We will be working with Brandon to deliver a demonstration of this product for our clients and friends in the near future. Be on the lookout for an announcement.

(Ed Wilmesherr)

WE KNEW IT WAS COMING; CFPB PROPOSES HMDA "PLUS" RULES

On July 24, 2014, the CFPB proposed rules to complete one of the remaining unfinished items contained in the Dodd-Frank Act. Section 1094 of Dodd-Frank amended the Home Mortgage Disclosure Act to expand HMDA data collection and to revise Federal agency rulemaking and enforcement authorities. In the proposal, the Bureau said it viewed implementation of the HMDA changes as an opportunity to also assess other ways to improve upon the data collected, reduce unnecessary burden on financial institutions, and streamline and modernize the manner in which financial institutions collect and report HMDA data.

In summary, the Bureau is proposing changes to the tests for determining which financial institutions and what credit transactions are covered under HMDA. The Bureau is also proposing to require financial institutions to report the new data points listed in Dodd-Frank plus additional data points the Bureau believes are necessary to effectuate the purposes of

HMDA. In addition, the Bureau is proposing to better align the requirements of Reg. C to existing industry standards, where practicable. To "improve" the quality and timeliness of HMDA data, the Bureau said it is also proposing to require financial institutions who report a large number of transactions to submit HMDA data quarterly, rather than annually. To minimize costs to HMDA reporters associated with making HMDA data available to the public, the Bureau is proposing to allow reporters to direct the public to a website to obtain the data. The Bureau is also proposing several changes to clarify and provide additional guidance on existing requirements of Reg. C which it believes may be confusing or unclear. The Bureau solicited comment on a number of issues involved with this proposal, including each specific proposed amendment. The comment period expires on October 22, 2014.

Proposed Changes to Coverage

The Bureau is proposing changes to both the types of institutions and types of transactions covered by HMDA. The Bureau is proposing to revise Reg. C's institutional coverage test by adopting a uniform loan volume threshold of 25 loans (excluding HELOCs) for both depository institutions (banks, savings associations, and credit unions) and nondepository institutions (other for-profit mortgage lenders). Currently, depository institutions that meet the asset threshold (currently $43 million), have a home or branch office in a MSA, and originate one first-lien home purchase loan or refinancing secured by a one-to-four family dwelling must collect and report HMDA data, while some nondepository institutions that originate as many as 99 home purchase or refinancing loans, annually, do not have to collect and report HMDA data. The asset threshold for depository institutions and the MSA office location test would remain unchanged.

The Bureau believes this proposal will improve the quality of HMDA data by increasing reporting by nondepository institutions. In addition, the Bureau is concerned that the current requirement for depository institutions to report even if they originate only one mortgage loan may impose costs not justified by the benefits. Depository institutions that originate fewer than 25 loans annually would be relieved of the burden of reporting HMDA data without significantly impacting the quality of the data for analysis at the national, community, or institutional level.

The Bureau is also proposing to generally expand the types of loans subject to Reg. C, while eliminating the requirement to report unsecured home improvement loans. Currently, Reg. C requires reporting of three types of loans: home purchase, home improvement, and refinancings. Reverse mortgages are reported under the existing rule only if they are home purchase loans, home improvement loans, or refinancings, but they are not separately identified as such, and many data points do not match up with the features of reverse mortgages. In addition, reporting of the home-equity lines of credit is optional under the existing rule. As a result, the Bureau believes HMDA data contains gaps regarding important segments of the housing market.

Under the proposal, all loans secured by a dwelling would be reportable, including closed-end loans, open-end lines of credit, and reverse mortgages. Unsecured home improvement loans would no longer be reported. Financial institutions would no longer have to determine the purpose of the loan for coverage purposes, but dwelling-secured loans would still be categorized by purpose in reporting. Commercial loans secured by a dwelling will continue to be reported. Certain types of loans would continue to be excluded, including loans on unimproved land, temporary financings and purchase of loans as part of a merger or branch acquisition. Reverse mortgages and open-end lines of credit would have to be identified as such to allow for differentiation from other loan types, and some of the data points would be modified to take into account the characteristics of different types of loans. The Bureau believes

these proposals will yield more consistent and useful data and better align Reg. C with the current housing finance market.

Proposed Changes to Reportable Data

The Bureau believes that it can make HMDA compliance and data submission easier for HMDA reporters by aligning, to the extent practicable, Reg. C requirements with existing industry standards for collecting and transmitting data on mortgage loans and applications. The Bureau is proposing to align many of the HMDA data requirements with the widely-used Mortgage Industry Standards Maintenance Organization (MISMO) data standards for residential mortgages. The Bureau believes that having consistent data standards for both industry and regulatory use promotes regulatory compliance, improves regulatory clarity, market efficiency, and data utility.

The Bureau is proposing to add new data points to the reporting requirements and to modify certain other existing data points. Many of the new data points are specifically identified by the Dodd-Frank Act. Others are proposed pursuant to the Bureau's discretionary rulemaking authority. The data points that the Bureau is proposing to add or modify can be grouped into four broad categories (items marked with a * are required by Dodd-Frank).

<u>Information about applicants, borrowers, and the underwriting process</u>. New data elements include: age*, credit score* (the score relied upon and the name and version of the scoring model), debt-to-income ratio, reasons for denial (for all denied applications), the application channel* (direct or through a broker), and the name and results of any automated underwriting system used.

<u>Information about the property securing the loan</u>. New or changed data elements include: construction method (site built or manufactured home), property value*, lien priority, the number of individual dwelling units in the property, type of property (principal residence, second home or investment property), combined loan to value (including senior and subordinate liens), and additional information about any manufactured housing (whether it is classified as real or personal property and whether the applicant owns or leases the land on which it will be located).

<u>Information about the features of the loan</u>. New and changed data elements include: the rate spread between APR and APOR for all loans*, HOEPA status , reason for HOEPA loan status (APR, points and fees, or both), total points and fees*, total of all borrower paid origination charges, discount points, the loan interest rate and the rate that would have applied absent discount points, and the term of any prepayment penalty*. Other additional data points include the loan term*, introductory rate period* (number of months until first rate change), existence of any non-amortizing features* (balloon payment, interest only payments, or negative amortization), and the type of loan (HELOC, reverse mortgage, whether the loan is subject to ATR, and whether the loan is a QM).

<u>Unique identifiers</u>. New or changed data elements include required use of a universal loan identifier* (including a legal entity identifier for the lender followed by the reporter’s loan or application identifier), property street address, and loan originator NMLSR number*.

Proposed Changes to Disclosure and Reporting

Reg. C currently requires financial institutions to submit their HMDA data to the appropriate Federal agency by March 1 following the calendar year for which the data are compiled. The Bureau is proposing to require financial institutions that report at least 75,000 covered loans to submit their data quarterly, rather than annually. The Bureau estimates that, based on 2012 data, quarterly reporting would have applied to

about 28 institutions in 2013. The Bureau believes that quarterly reporting will allow regulators to use the data more effectively, reduce reporting errors, improve data quality, and facilitate earlier release of annual HMDA data to the public.

The Bureau also is proposing to allow HMDA reporters to make their disclosure statements available by referring anyone who requests a disclosure statement to a publicly-available website. Currently, a financial institution must make its disclosure statement available to the public at its home office and, in addition, either make it available in certain branch offices or post notice of its availability and provide it in response to a written request. The Bureau believes that this proposal will facilitate public access to HMDA data while minimizing burdens to financial institutions. The Bureau is still mulling over privacy concerns about making information about the new expanded data points available to the public. Initially, the Bureau proposes to leave the publicly disclosed LAR data unchanged and seeks comment on any privacy risks created by disclosing the new data points.

Proposed Clarifications

Financial institutions and others have, over time, identified aspects of Reg. C that are unclear or confusing. The Bureau believes that the implementation of the Dodd-Frank Act amendments is an opportunity to address many of these by revising the regulations, the instructions in appendix A, and the staff commentary. Examples of these clarifications include guidance on what types of residential structures are considered dwellings; the treatment of manufactured and modular homes and multiple properties; coverage of preapproval programs and temporary financing; how to report a transaction that involved multiple financial institutions; reporting the action taken on an application; and reporting the type of purchaser for a covered loan. The Bureau did not provide any additional clarification on the definition of an application or attempt to reconcile the definition of that term with the definition used in RESPA.

Conclusions

If adopted as proposed, the Reg. C changes will add significantly to the burdens of HMDA reporters to collect the data and compile an accurate LAR. The burden will be even greater for those institutions with a manual process. The required additional data points will present many more opportunities for errors, as well. The CFPB is seeking comment on a variety of issues in proposing the rule, and it may well be worth a bank taking the time to study the entire CFPB issuance and to prepare a carefully considered comment letter including specific comments about the overall cost and burden of compliance. There is no question but that the CFPB will adopt a final rule that will increase the number of data elements to be included on the LAR. After all, about half of the new data points are mandated under Dodd-Frank. However, the Bureau might be persuaded to lower the burden on reporters in other ways where it has the authority to do so if it can be convinced that the burden and costs outweigh the perceived benefits. Remember, the comment period expires October 22, 2014.

By the way, no mention was made of the Dodd-Frank requirement for HMDA-like reporting for small business loans. That is still somewhere on the horizon.

(Cliff Harrison)

CFPB GUIDANCE ON MORTGAGE BROKERS CHANGING TO MINI-CORRESPONDENT LENDERS

On July 11, 2014, the CFPB issued a guidance entitled "Policy Guidance on Supervisory and Enforcement Considerations Relevant to Mortgage Brokers Transitioning to Mini-Correspondent Lenders" concerning the Bureau's enforcement of compliance with RESPA Reg. X and TILA Reg. Z in transactions involving "mini-correspondent”

lenders. The CFPB is concerned that some mortgage brokers were restructuring their business to become mini-correspondent lenders in the possible belief that doing so would avoid some RESPA and TILA requirements applicable to mortgage brokers. The Bureau issued the Guidance to identify for all concerned the types of questions the Bureau will consider in exercising its supervisory and enforcement authority with respect to those situations.

The Bureau is concerned that brokers switching to a mini-correspondent model may be attempting to avoid certain requirements and prohibitions concerning mortgage brokers contained in Reg. X and Reg. Z including the following:

- **Disclosure of mortgage broker compensation.** Reg. X requires that compensation paid to the broker be disclosed on the GFE and HUD-1. By contrast, payments received by a correspondent lender from an investor in a true secondary market transaction do not have to be disclosed. Depending on the circumstances, payments by a lender to a broker could also raise issues under the RESPA prohibition on payment of referral fees and fee splitting while amounts paid for the sale of a loan in a secondary market transaction should not.

- **Inclusion of mortgage broker compensation in "points and fees."** Under Reg. Z, compensation paid to a broker by a consumer or lender must be included in points and fees for purposes of determining whether the loan is a "qualified mortgage" and whether the loan is a HOEPA "high-cost mortgage." Interest paid to a creditor is not included in points and fees, nor is the payment a creditor receives from a third party that purchases the loan in a secondary market transaction.

- **Restrictions on mortgage broker compensation.** Reg. Z prohibits certain compensation to loan originators, including mortgage brokers, based on the loan terms, and mortgage brokers may not receive compensation from both the consumer and the creditor. These restrictions do not apply to amounts paid to a creditor by an investor that purchases the loan.

- **Prohibition on steering to increase mortgage broker compensation.** Reg. Z prohibits loan originators, including mortgage brokers, from "steering" consumers to transactions to increase the mortgage broker's compensation.

A correspondent lender, as generally understood in the mortgage industry, performs the activities necessary to originate a mortgage loan, i.e., it takes on the tasks usually performed by the originating lender. The correspondent lender takes and processes applications, provides required disclosures, and often, although not always, underwrites loans and makes the final credit decision. The correspondent lender closes loans in its name, funds them (often through a warehouse line of credit), and sells them to an investor by prior agreement. A full correspondent lender may have agreements with multiple investors.

Reg. X defines a mortgage broker as a person, other than an employee of a lender, who renders origination services and serves as an intermediary between a borrower and lender, including a person that closes the loan in its own name in a "table-funded” transaction. "Table-funding" occurs when the loan is funded by a contemporaneous advance of loan funds followed by an assignment of the loan to the person advancing the funds. In table-funding, the third party who advances the loan funds and takes an initial assignment of the loan at or after settlement is the lender, and the person or entity that acts as the intermediary is a mortgage broker (even if that entity closes the loan in its own name). However, a "bona fide transfer of a loan obligation in the secondary-market" is not covered.

The Bureau believes that some brokers may be setting up arrangements with wholesale lenders in which they purport to act as mini-

correspondent lenders where the broker, in form, appears to be the lender (by engaging in activities such as closing the loan in its own name, funding the loan from what is designated as a warehouse line of credit, and receiving compensation through what appears to take the form of a premium for the sale of the loan to an investor). However, in substance, the brokers may be continuing to act as a broker and the "investors" may be acting as a wholesale lender to the broker rather than as a purchaser of loans in the secondary market. Such an "investor" may continue to perform the same origination activities it would perform as a traditional wholesale lender to the broker and may also provide the warehouse line of credit that the so-called "mini-correspondent" uses to fund its loans.

The Bureau said the requirements of RESPA and TILA do not depend on the labels the parties apply, but rather on the substance of the transaction and whether the compensation is part of a true secondary market transaction or a "table-funded" transaction. In exercising its authority, the Bureau will consider factors that evidence the true nature of the mortgage transaction. The Bureau will consider the "real source of funding" for the loan and the "real interest of the funding lender" in determining what constitutes a bona fide transfer.

Under Reg. X, a table-funded transaction is *not* a secondary-market transaction. Similarly under Reg. Z, loan originator compensation requirements apply to compensation paid to brokers in "table-funded" transactions. Under Reg. Z, a creditor is a person who regularly extends credit and to whom the obligation is initially payable on the face of the note. For purposes of the loan originator compensation requirements, however, a "loan originator" includes such a creditor if it engages in loan origination activity and "does not finance the transaction at consummation out of the creditor's own resources, including by drawing on a *bona fide* warehouse line of credit." In other words, the term loan originator, for purposes of the loan originator compensation restrictions, includes any creditor that otherwise satisfies the definition of loan originator and makes use of "table funding" by a third party.

Questions the Bureau May Consider in Exercising Its Authority in Transactions Involving Mini- Correspondents: In exercising its supervisory and enforcement authority, the Bureau may ask the following questions relevant to the true nature of the mortgage transaction:

- Beyond the particular mortgage in question, does the mini-correspondent still act as a mortgage broker in some transactions, either brokering to the same wholesale lender that supplies the warehouse line of credit or otherwise?
- If so, what distinguishes the mini-correspondent's "mortgage broker" transactions from its "lender" transactions?
- How many "investors" does the mini-correspondent have available to it to purchase loans?
- Is the mini-correspondent using a bona fide warehouse line of credit as the source to fund the loans that it originates?
- Is the warehouse line of credit provided by a third-party warehouse bank?
- How thorough was the process for the mini-correspondent to get approved for the warehouse line of credit?
- Does the mini-correspondent have more than one warehouse line of credit?
- Is the warehouse bank providing the line of credit one of, or affiliated with any of, the mini-correspondent's "investors" that purchase loans from the mini-correspondent?
- If the warehouse line of credit is provided by an investor to whom the

mini-correspondent will "sell" loans to, is the warehouse line a "captive" line (i.e., the mini-correspondent is required to sell the loans to the investor providing the warehouse line (or affiliates of the investor))?

- What percentage of the mini-correspondent's total monthly originated volume is sold by the mini-correspondent to the entity providing the warehouse line of credit to the mini-correspondent, or to an investor related to the entity providing the warehouse line of credit?
- Does the mini-correspondent's total warehouse line of credit capacity bear a reasonable relationship, consistent with correspondent lenders generally, to its size (i.e., its assets or net worth)?
- What changes has the mini-correspondent made to staff, procedures, and infrastructure to support the transition from mortgage broker to mini-correspondent?
- What training or guidance has the mini-correspondent received to understand the additional compliance risk associated with being the lender or creditor on a residential mortgage transaction?
- Which entity (mini-correspondent, warehouse lender, investor) is performing the majority of the principal mortgage origination activities?
- Which entity underwrites the mortgage loan before consummation and otherwise makes the final credit decision on the loan?
- What percentage of the principal mortgage origination activities, such as the taking of loan applications, loan processing, and pre- consummation underwriting, is being performed by the mini-correspondent, or an independent agent of the mini-correspondent?
- If the majority of the principal mortgage origination activities are being performed by the investor, is there a plan in place to transition these activities to the mini-correspondent?
- What conditions must be met to make this transition (e.g., number of loans, time)?

The Bureau said its list of questions is not exhaustive, and no single question is necessarily determinative. All of the facts and circumstances are relevant. The Bureau intends to closely monitor the practices of mini-correspondents, including former mortgage brokers that have converted, to ensure that consumer protections are not being evaded. In doing so, the Bureau warns that it will use all appropriate tools to assess whether supervisory, enforcement or other actions are necessary.

Conclusion. For some time now, banks have been getting into or expanding their mortgage lending business by acquiring or affiliating in some fashion with non-bank mortgage loan origination businesses including lenders and brokers. Those acquisitions and affiliations can raise a host of legal and compliance issues not the least of which is compliance with the RESPA disclosure and TILA originator compensation requirements discussed in the CFPB Guidance. RESPA prohibitions on referral fees and fee splitting and required disclosure of affiliated business arrangements are often key compliance issues as well. The Guidance is a clear indication that the CFPB is suspicious of any business arrangement which has the potential to be used as a means of evading consumer protections and that it will look to the substance, and not the form, of any such arrangement in its supervision and enforcement efforts. There should be little doubt that the other federal bank regulatory agencies will do the same.

(Cliff Harrison)

WHEN LAWS COLLIDE

On June 26, 2013, the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act (DOMA). That provision in DOMA had sought to define "marriage" as only a legal union between one man and one woman as husband and wife and the word "spouse" as only a person of the opposite sex who is a husband or a wife. The intent had been to deny same-sex couples the ability to marry.

By last count, federal courts in some 20 states have now struck down state statutes that attempt to prohibit same-sex marriages. Some decisions have dealt with a state law that refuses to recognize a same-sex marriage performed in another state that recognizes such marriages.

For instance, Mississippi has a state statute that provides in part:

> Any marriage between persons of the same gender is prohibited and null and void from the beginning. Any marriage between persons of the same gender that is valid in another jurisdiction does not constitute a legal or valid marriage in Mississippi. (§ 93-1-1, Mississippi Code of 1972.).

Although we are not aware of a challenge to Mississippi's statute, it seems doubtful that it could withstand a challenge, given the Supreme Court's ruling that laws such as these deny equal protection rights to couples in same-sex marriages.

The CFPB has now weighed in on the issue and has issued its Memorandum on Ensuring Equal Treatment for Same-Sex Married Couples (June 25, 2014).

In its Memorandum, the CFPB takes the position that a person who is married under the laws of any jurisdiction will be regarded as married nationwide for purposes of the federal statutes and regulations under the CFPB's jurisdiction, regardless of the person's place of residency. Persons married only by virtue of domestic partnership (common-law marriage, civil union, or other relationship not denominated by law as a marriage) will not be regarded as married. The CFPB lists the following laws and regulations as being affected by this memorandum:

> Equal Credit Opportunity Act (ECOA) and Regulation B;
> Fair Debt Collection Practices Act (FDCPA);
> Interstate Land Sales Full Disclosure Act (ILSA) and Regulation J;
> Truth in Lending Act (TILA) and Regulation Z;
> Real Estate Settlement Procedures Act (RESPA) and Regulation X.

Regardless of whether you agree with the Supreme Court, the CFPB, or the 20 federal District and Circuit Courts of Appeal, the message and the trend are clear. Customers that are validly married as a same-sex couple have the same protections under laws and regulations as any other married couple.

We will be looking at the manner in which the Compliance Manual may need to be adjusted to take into account this changed circumstance.

(Ed Wilmesherr)

ATR AND SUCCESSORS-IN-INTEREST

When Is An Assumption
Not Really An Assumption?

On July 11, 2014, the CFPB issued an interpretive rule clarifying when the ability-to-repay rule applies when a successor-in-interest to a borrower has acquired title to a dwelling and the successor and creditor wish to add the successor as an obligor on the loan. The Bureau has been asked whether the creditor is obligated to determine a successor's ability to repay the mortgage before formally adding the successor as an obligor.

The CFPB said the issue most often arises in the case of the death of the original borrower where ownership of the home is transferred to a surviving spouse, children or other family members; but it may also arise in other circumstances, such as in a separation or divorce, a transfer from living parents to children or a transfer to an inter vivos trust in which the consumer is a beneficiary. The successor has received a legal interest in the property by operation of law on the borrower's death, or by transfer from a family member, or, perhaps, under a divorce decree or separation agreement. The successor is not personally liable for the loan, but may wish to be added to or to assume the loan. If the ATR rule applies, the Bureau noted that creditors would be much less likely to allow a successor to be added to the loan which could impose significant adverse consequences for the successor. For example, the successor might seek a modification in order to be able to retain the home, either temporarily or permanently, or to prevent a possible foreclosure. Creditors may be less likely to work with a successor who is not an obligor on the loan due to privacy concerns or fear that a modification entered into with the successor might not be binding.

In its interpretative rule, the CFPB tied application of the ATR rule to an assumption under §1026.20(b) of Reg. Z. Where the addition of the successor as an obligor on the loan or the substitution of the successor as the primary obligor is <u>not</u> an assumption under §1026.20(b), then the ATR rule does <u>not</u> apply. If the transaction is an assumption under §1026.20(b), then the ATR rule does apply.

Most lenders tend to think of the word "assumption" as encompassing any transaction where the lender agrees that another person may assume the obligation to repay the loan. However, the definition of "assumption" under Reg. Z is not that broad. Section 1026.20(a) and (b) provide that if a creditor and consumer enter into a transaction that constitutes a "refinancing" or an "assumption", that is a new transaction requiring all new disclosures. A refinancing under 20(a) involves changes to a loan's terms while an assumption under 20(b) involves a change in the loan's obligors. If a transaction constitutes a "refinancing" under 20(a), then the ATR rule applies. Likewise, if the transaction is an assumption under 20(b), then the ATR rule also applies. However, the Bureau noted that the addition of a successor as a named obligor generally will not constitute an "assumption" under 20(b).

Looking to the existing regulation and commentary, the Bureau noted that under 20(b), an assumption occurs when – and only when – the creditor "expressly agrees in writing with a subsequent consumer to accept that consumer as a primary obligor on an existing residential mortgage transaction." A "residential mortgage transaction" is a transaction in which a consumer finances the acquisition or initial construction of the consumer's principal dwelling. For purposes of determining whether the transaction is an "assumption", the creditor must look to whether the new obligor is seeking to finance the acquisition of that new obligor's principal dwelling. Whether the existing loan was a residential mortgage transaction as to the original borrower is immaterial; the creditor must look to the assuming consumer in determining whether a residential mortgage transaction exists. A residential mortgage transaction does not arise where a successor takes on liability for payment of the debt that is secured by property which the successor has already acquired. For example, when the original borrower dies, the successor acquires title to the property by operation of law, typically, under a will, the laws of heirship or by virtue of some form of ownership with a right of survivorship. Adding that successor, who already has an interest in the property, on the existing loan is not an assumption under §1026.20(b) because the transaction is not a residential mortgage transaction. That remains the case even if the lender agrees in writing to the addition of the new obligor.

In contrast, if a consumer without an existing interest in the property takes on the obligation

to pay the loan in order to finance the acquisition of the assuming consumer's principal dwelling, the transaction is a residential mortgage transaction. In that case, if the creditor agrees in writing to the new obligor, an "assumption" has occurred under §1026.20(b), and the assumption is a whole new transaction subject to the ATR rule and other Reg. Z requirements.

The interpretive rule is an official interpretation and has the same force and effect as the regulation. It clarifies that adding an heir who has acquired an interest in the home as a borrower on the mortgage does not trigger the ATR rule. The ruling does not require creditors to permit assumption or offer up loan modifications to heirs of deceased borrowers, but should make it easier for creditors to work with those heirs who wish to remain in the home.

(Cliff Harrison)

FDIC REFOCUSES ON DPC REAL ESTATE HOLDING PERIOD

FDIC regulated Mississippi banks may have received a recent letter co-authored by the FDIC and the Mississippi Commissioner of Banking regarding holding periods for real estate. The letter points out some differences in Mississippi and federal law while emphasizing that state chartered non-member banks must comply with both state and federal law. The letter also underscores a new focus by the FDIC on this issue.

Under Mississippi law, if real estate acquired through debts previously contracted ("DPC") is not sold within five years of being acquired, the bank must make an application to the Commissioner for an extension. If the property is not sold within ten years of being acquired, the bank must write the property down to $1.00.

Mirroring Mississippi law, federal law requires non-member banks to dispose of DPC real estate with five years of acquisition or apply to the FDIC for an extension. However, federal law only allows for a single five year extension regardless of whether the property has been written down to $1.00. In short, federal law requires non-member banks to dispose of DPC property no later than ten years after it is acquired.

In the past, we understand that FDIC examiners have allowed Mississippi banks to hold DPC property longer than ten years so long as the bank complied with Mississippi's obligation to carry the asset at a $1.00 book value after ten years. The letter confirms that the FDIC has begun to focus some attention on this issue, and banks should be aware of their obligations.

To hold DPC real estate beyond ten years, a non-member bank must apply to the FDIC to engage in the otherwise impermissible activity. The application is made pursuant to Part 362 of the FDIC regulations, and some circumstances may qualify for an abbreviated notice filing instead of the full application. Even if the Part 362 application is granted, Mississippi law continues to obligate the bank to carry the asset at $1.00 after ten years.

Banks should work now to evaluate any DPC property in their possession to determine whether any action needs to be taken. Also, be aware of the following:

- *Future Expansion Property*. Real estate owned by a bank for future expansion is not addressed in the recent letter, although banks that hold that property should consider whether action should be taken with respect to that property.
- *Grandfather Clause*. DPC property that the bank has held since October 15, 1982 is grandfathered under the FDIC regulations, but not Mississippi law.
- *Mineral Rights*. Mineral rights acquired through DPC are subject to the same obligations as ordinary real estate interests.

- *Property Held by Bank Subsidiary*. These obligations apply equally to real estate held in a subsidiary of the bank

(Jeff Stancill)

REPETITIVE CREDIT DISPUTE LETTERS

It has been brought to our attention that many of you are receiving an increasing number of letters from consumers or, possibly, credit repair organizations disputing information provided by the bank to a consumer reporting agency (CRA), and many of those letters repeat disputes asserted by the same consumer in prior letters. Oftentimes, the letters appear to be form letters the consumer likely obtained from some third party source or off the Internet. The letters are frequently repetitive, and it sometimes seems the consumer is hopeful the bank will get tired of responding and stop reporting the negative information or that the bank will make a mistake and not respond opening the door to possible civil liability. A bank's response to these letters depends, in part, on whether or not the letters are sent directly from the consumer or, either directly or indirectly, by a credit repair agency.

Both the Fair Credit Reporting Act Regulation V and RESPA Regulation X may come into play depending on the type of account that is the subject of the dispute. Under the FCRA and Reg. V, a furnisher of information to a CRA must conduct a reasonable investigation of a direct dispute that relates to the consumer's liability for a credit account or debt with the furnisher, including the terms of the account, account balance, performance history, etc. While the mortgage servicing rules under RESPA Reg. X do not relate to reporting of information to a CRA, those rules do require a servicer to investigate and respond to a written notice of any error with respect to servicing the borrower's mortgage loan, and a consumer dispute might easily involve an alleged error in servicing the loan that also results in reporting erroneous information to a CRA.

Under FCRA Reg. V, if a dispute is sent by the consumer, then the bank generally must investigate the dispute and respond as usual, within the thirty day time frame, provided: the notice is sent to an appropriate address, contains enough specific information to identify the account or relationship in dispute (for example, by providing the account number, name and address), explains the basis for dispute and includes any supporting documentation. If the bank determines that information reported to a CRA was inaccurate, then corrected information must be promptly provided by the bank to the CRA.

However, if the bank has reasonably determined that a direct dispute from a consumer is frivolous or irrelevant or the bank has a reasonable belief that the dispute is "submitted by, is prepared on behalf of the consumer by, or is submitted on a form supplied to the consumer by, a credit repair organization," then investigation is not required.

A bank may make the determination that a dispute from a consumer is frivolous or irrelevant in three circumstances. First, the determination can be made if the customer does not provide all appropriate information in its initial letter, as set forth above. Second, the determination can be made if the consumer fails to provide sufficient information to investigate. Or, third, a dispute is frivolous or irrelevant if it is "substantially the same as a dispute previously submitted by or for the consumer, either directly or to the [bank] through a consumer reporting agency" and the bank has already conducted the required investigation, reviewed all relevant information provided by the consumer or CRA, reported the results of the investigation to the consumer or CRA, as applicable, and made any correction to the information reported that are necessary. In those instances, an investigation, or additional investigation is not required.

If the bank determines that the dispute is frivolous or irrelevant, the bank must send notification of such determination to the consumer within five business days of making such determination. The notice should provide the consumer with the reason for the determination and examples of the types of information required in order to conduct an investigation. It is important that the bank respond in a timely fashion to each dispute from a customer, even repetitive ones, but it is permissible for a bank to use a standard form letter response in these instances. Of course, a bank will need to carefully review each dispute received to see if it is truly repetitive or not before deciding whether an investigation is required. A dispute is not considered repetitive if it includes information about the account, the basis for the dispute or supporting documentation that was not previously furnished to the bank.

Many of the letters banks are receiving are plainly form letters the borrower obtained from some third party source. While the forms may well have been obtained from a credit repair organization, it is probably not a good idea to assume that, just because a form letter was used, it came from a credit repair organization. In order for a bank to say it had a reasonable belief the form was submitted by or obtained from a credit repair organization, something more than just the fact the dispute is on an obvious form letter should probably be required. But, again, it may be possible for the bank to respond with a form of its own if the dispute is otherwise frivolous or irrelevant.

For home loans, remember that RESPA Reg. X may also apply. Reg. X requires a mortgage loan servicer to respond to a written notice of error received from a borrower, or an agent of the borrower, if the notice contains the name of the borrower, account identifying information, and a description of the alleged error. The rule sets forth ten specific instances which constitute an error and one catchall which is "[a]ny other error relating to the servicing of a borrower's mortgage loan" and includes timelines for responding. A bank must provide an acknowledgement of receipt of a notice of error to a borrower within five business days of receipt (Saturdays, Sundays and legal holidays are excluded). The bank must conduct a reasonable investigation to determine if any error occurred. If an error is found, the bank must correct the error and provide the borrower with notification that the correction was made, on what date, and include bank contact information the borrower can use for further assistance. If no error is found, then the borrower must be informed of that determination, the reasons for that determination, the borrower's right to request any documents relied on by the bank in making that determination, and contact information the borrower can use for further assistance.

Similar to FCRA, a mortgage loan servicer is not required to investigate a repetitive notice of an error that is substantially the same as an error previously asserted by the borrower. A servicer is also not required to investigate if the notice of error is so overbroad that the servicer cannot reasonably determine what error the borrower is attempting to assert or if the notice of error is received more than one year after either servicing has been transferred to another servicer or the loan has been paid off. In those instances, however, the bank must still respond in writing within 5 days after receipt of the borrower's notice and state the basis for the bank's determination that no investigation is required. Again, a form letter could be developed and used for this purpose where the bank is receiving repetitive notices.

(Memrie Fortenberry)

GUIDANCE ON HOME EQUITY LINES OF CREDIT NEARING THEIR END-OF-DRAW PERIODS

On July 1, 2014, the Agencies jointly issued guidance regarding the treatment of home equity lines of credit (HELOCs) nearing their end-of-draw period. The Agencies' concern,

which prompted the guidance, is that many borrowers may have difficulty making higher payments resulting from transitioning a HELOC from the draw period to full repayment. The guidance sets forth management principles and expectations for use in these situations, particularly for borrowers facing financial difficulties.

The five risk management principles provided for in the guidance are: prudent underwriting for renewals, extensions and modifications; compliance with existing guidance; use of well-structured modification and work-out terms; appropriate accounting and reporting and identification of troubled debt restructurings (TDRs); and the consideration of losses associated with HELOCs at their end-of-draw periods when estimating ALLL.

The first principle is the use of prudent underwriting. Using prudent underwriting for renewals and extensions includes conducting a complete evaluation of the borrower's ability to repay an obligation prior to transitioning a HELOC to full repayment.

Second, the Agencies have previously adopted relevant guidance that should be reviewed and considered when developing underwriting criteria, policies, and procedures. All such documents should be consistent with all existing and relevant regulatory guidance and should be approved by management and include procedures for regular review, reporting and policy exceptions. Underwriting criteria should include standards for the following: debt service capacity; credit worthiness; equity requirements; collateral requirements; and allowable loan amounts, maturities and terms.

Third, workout and modification programs should be established and used for borrowers facing financial difficulties. These programs should be tailored to meet the needs of each borrower's current situation. Higher-risk borrowers should be placed in programs that allow for repayment of all amounts owed rather than in interest-only or balloon payment loans.

The fourth principle is the use of appropriate accounting, reporting and disclosure of TDRs. It is appropriate to use TDR treatment when a lender grants a concession to a borrower experiencing financial difficulties such as the expectation that a borrower will not be able to meet the new loan terms or payment shock associated with an increase in monthly payments.

The final risk management principle is that HELOCs approaching their end-of-draw periods should be separately accounted for in the ALLL estimation process. Management should analyze exposure before significant volumes of HELOCs reach their end-of-draw periods.

The guidance also sets forth end-of-draw risk management expectations. Policies and procedures should be established and factors to consider when drafting are set forth in the guidance. The expectations are summarized as follows:

1. Management should have a clear understanding of end-of-draw period exposures and conduct an analysis that includes identification of higher risk accounts.
2. A complete review of all end-of-draw contract provisions should be performed to ensure understanding of all rights and obligations provided for therein. This review should include monitoring of all related options, such as available extensions or rate locks, and a clear understanding of all required disclosures and/or notifications.
3. Risks associated with HELOCs nearing their end-of-draw periods should be reviewed and monitored particularly in instances in which collateral value has declined or the borrower may have problems with repayment. Borrowers making interest-only payments should be evaluated in order to determine whether they will qualify for renewal based on the institution's current underwriting policies and procedures.

4. Procedures for contacting borrowers prior to their end-of-draw date should be in place and adhered to by lenders.
5. Institutions must be in compliance with regulatory guidance and consumer protection laws and regulations when establishing workout and modification programs.
6. Guidelines and procedures for end-of-draw options and alternatives should be established and implemented institution wide.
7. Easy to understand information regarding end-of-draw options such as modifications and all relevant qualifying criteria should be provided to higher-risk borrowers along with the lender's contact information.
8. Detailed monitoring and reporting of any actions on HELOCs taken at their end-of-draw periods should be made frequently to management and include exceptions. The reports should track performance according to the action taken at the end-of-draw period on accounts. For example, the reports should be classified according to modification, temporary modification, renewals, longer-term amortization, short term extensions, etc.
9. Higher-risk borrowers should be monitored separately from other HELOC borrowers because of their higher repayment risk for ALLL purposes.
10. Testing to ensure that appropriate controls are in place to ensure that: credit approval is required when extending draw periods and interest-only periods; servicing systems appropriately and accurately consolidate balances, calculate payments and process billing statements for all repayment periods resulting from the end of a draw period; the bank has the appropriate staff required to handle all offered program activities; all notifications to borrowers are made timely and appropriately within any guidelines; and makes timely reports to management so that appropriate and accurate monitoring can be conducted.

(Memrie Fortenberry)

MRCG MEETING TO BE HELD ON AUGUST 21, 2014

The MRCG will hold its August Quarterly Meeting on August 21, 2014, at the Mississippi Sports Hall of Fame & Museum Conference Center, 1152 Lakeland Drive, Jackson, Mississippi. Registration will begin at 9:00 a.m. with the meeting to begin at 9:30 a.m..

During the August Quarterly Meeting we will feature a special presentation by Brandon Roberts of the loan pricing and underwriting model that he has developed to aid with Fair Lending compliance. We will also discuss the newly proposed HMDA data reporting requirements, recent guidance on mini-correspondent mortgage lending relationships, guidance on the treatment of loan applicants in same-sex marriages, and the results of recent BSA examinations.

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 to Liz Crabtree no later than Friday, August 15, 2014, so that arrangements for lunch can be finalized. We look forward to seeing you there.

(Ed Wilmesherr)

MSRCG MEETING TO BE HELD ON AUGUST 26, 2014

The MSRCG will hold its August Quarterly Meeting on August 26, 2014, at The Racquet Club of Memphis in the Large Ballroom located at 5111 Sanderlin Avenue, Memphis, Tennessee. Registration will begin at 9:00 a.m. with the meeting to begin at 9:30 a.m.

During the August Quarterly Meeting we will feature a special presentation by Brandon Roberts of the loan pricing and underwriting model that he has developed to aid with Fair Lending compliance. We will also discuss the newly proposed HMDA data reporting requirements, recent guidance on mini-correspondent mortgage lending relationships, guidance on the treatment of loan applicants in same-sex marriages, and the results of recent BSA examinations.

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(Ed Wilmesherr)

MRCG-MSRCG COMPLIANCE CALENDAR

07/06/12 – Increased CMPs for flood violations effective	01/18/14 – HPML appraisal rule, Reg. B rule on delivery of copy of appraisal effective
03/26/13 – Reg. E requirement for posting fee notice on ATMs repealed.	07/06/14 – Escrows for flood insurance premiums required for $1B + institutions
03/28/13 Reg. Z amendment limiting first year fees on credit card account effective	07/17/14 – MRCG/MSRCG Joint Steering Committee Meeting
05/03/13 – Comment period on proposed amendment to 2013 escrow rule expires	08/21/14 – MRCG Quarterly Meeting
05/17/13 – Comment period on proposed CRA Q&A expires	08/26/14 – MSRCG Quarterly Meeting
06/01/13 – Escrow accounts for higher-priced mortgages expands to 5 years	09/18/14 – MRCG/MSRCG Joint Steering Committee Meeting
06/01/13 – Mandatory arbitration and financing credit life on mortgage loans prohibited	11/18/14 – MSRCG Annual Meeting
07/01/13 – UCC Article 9 changes for individual debtors, trusts and estates effective	11/20/14 – MRCG Annual Meeting
01/10/14 – Ability To Repay, qualified mortgage, mortgage servicing, MLO compensation and qualifications, HOEPA high cost mortgage rules effective	08/01/15 – Mandatory use of revised TILA/RESPA disclosure takes effect