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Quarterly Report
Mid-South Regulatory Compliance Group

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GUIDANCE ON CIP FOR PREPAID CARDS

The use of prepaid cards has become highly scrutinized since it was discovered that they were used to fund terrorist activity related to the 2015 attacks in Paris. Prepaid cards pose potential risks for money laundering and other criminal activities because they can be easily obtained, used and possibly reloaded without requiring any identification from the cardholder. In an effort to better track and prevent such crimes in the future, the federal banking agencies and FinCEN recently issued guidance clarifying the CIP requirements for banks that issue prepaid cards.

The guidance first clarifies that whether or not a bank is required to obtain CIP on prepaid card accounts depends on whether or not an account is established with the bank as defined in Section 326 of the USA Patriot Act (the "CIP Rule"). There, an account is defined as "a formal banking relationship established to provide or engage in services, dealings or other financial transactions, including a deposit account, a transaction or asset account, a credit account or other extension of credit." For purposes of prepaid cards, an account is not established unless a prepaid card is reloadable or the cardholder is able to access funds in excess of the card balance through an overdraft or other credit feature. On the other hand, the general rule is that if a card is issued without reloadable, credit or overdraft features, then an account is not established between the bank and the cardholder. Some cards may be issued without the ability to be reloaded or have access to credit or overdraft features, but these features may be activated later. In those situations, an account is not created with the cardholder until those features are activated.

Once it has been determined that an account has been established with the bank and CIP is required, then the next step is to properly identify the bank's customer on which CIP must be obtained. This may vary for different types of prepaid cards.

There are three common types of prepaid cards: general use prepaid cards that can be reloaded, general use prepaid cards with access to credit or overdraft features, and general purpose cards that cannot be reloaded or access credit or overdraft features unless such features are activated by the issuing bank. As we noted, the basic rule is that if the card cannot be reloaded and does not have an overdraft or other credit feature, then an account has not been established between the bank and the cardholder and CIP on an individual prepaid cardholder is not required.

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For this type of card, the bank's only customer for CIP purposes is the entity that established the pooled account with the bank through which the cards are funded.

If a general purpose prepaid card that is reloadable or has overdraft or other credit features is issued, then an account between the bank and the cardholder has been established and the bank is required to obtain CIP on the individual cardholder even if he or she is not the named account holder. The cardholder may have received the card from a third party using a pooled account with the bank to fund bank-issued prepaid cards.

For example, if an employer uses prepaid cards to pay its employees, but the employer or a third party contracted by the employer, is the only one with the ability to deposit funds onto the card, then the employer is treated as the bank's customer for CIP purposes. The Bank will not have to obtain CIP information on each employee who may use the card to withdraw funds in that situation. On the other hand, if the employee can deposit funds onto the card or obtain funds greater than the amount originally loaded on the card through an overdraft or other credit feature, then the employee is subject to CIP. The same is true for government benefit cards, except that if the government entity is deemed to be the bank's customer, and not each individual beneficiary cardholder, then CIP is not required for the government entity under the CIP rule.

Prepaid cards are also commonly used in connection with Health Savings Accounts and Flexible Spending Arrangements/Health Reimbursement Arrangements. Health Savings Accounts are established by employees to receive reimbursements and pay for medical expenses. Typically, either the employee or the employer can contribute to the account. For this reason, the employee is considered the bank's customer for these purposes and CIP must be obtained. On the other hand, Flexible Spending Arrangements/Health Reimbursement Arrangements are only able to be established and funded by an employer, so the employer is the bank's customer and CIP is required for the employer but not for each individual employee cardholder.

The Guidance also addresses guidelines for banks when entering into contracts with third-party program managers. These contracts should clearly define the duties, expectations, rights and obligations of each party. At a minimum, the contracts should: (1) address the CIP obligations of each party; (2) set forth the right of the issuing bank to transfer, store, or obtain immediate access to all CIP information collected by the third-party program manager; (3) provide the issuing bank with the right to audit and monitor the third-party program manager; (4) if applicable, address the right of a relevant regulatory body to examine the third party program manager.

(Memrie Fortenberry)

MORE ON THE FLOOD RULES

While the final rules on loans secured by a dwelling or mobile home located in a special flood hazard area have been in effect for a while, we continue to hear a lot of questions on the rules and some particular issues that have arisen. As a result, we thought it would be a good idea to review the requirements and discuss some of the issues that have been raised at the quarterly meeting.

The most recent rule changes implemented changes and clarifications related to requirements for escrowing flood insurance payments, mandatory purchase requirements

for certain detached structures, and force placement of flood insurance. It also included two sample notices- the revised Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance and the new Sample Clause for Option to Escrow for Outstanding Loans.

Escrow

Lenders are now required to escrow premiums and fees for flood insurance upon a "MIRE" event occurs - when a designated loan secured by residential real estate or a mobile home is made, increased, renewed or extended after January 1, 2016 - unless an exemption applies. Lenders are also required to extend an offer of the option of escrow for flood insurance premiums and fees on non-exempt loans that were outstanding as of January 1, 2016. The deadline for this offer is fast approaching; it must be made by June 30, 2016. Non-exempt loans include loans that do not fall within any of the following categories: (1) subordinate loans secured by the same property on which flood insurance meeting the mandatory purchase requirement has already been obtained; (2) designated loans that are part of a condominium, cooperative, or other project development if the group policy meets the mandatory purchase requirement; (3) loans secured by covered property but made primarily for business, commercial or agricultural uses; (4) HELOCs; (5) loans that are 90 or more days past due until it is permanently modified, the entire past due amount is paid or the entire past due amount is discharged; and (6) loans with a term of less than 12 months.

There is a small lender exemption from the escrow requirement. It is available to lenders who meet the following criteria: (1) had total assets of less than $1 billion as of December 31 of either or both of the two immediately preceding previous years; (2) was not required to escrow taxes and insurance for the term of the loan on July 6, 2012; (3) and, also as of that time, did not have a policy of uniformly and consistently escrowing taxes and insurance.

A lender who was previously exempt, but later becomes covered by the escrow rule because it had assets of $1 billion or more for two consecutive year ends must begin escrowing for designated loans on July 1 of the calendar year during which the exempt status changed. Also, if a previously exempt lender loses the exemption, then the requirement to offer of the option to escrow for flood insurance premiums and fees must be provided by September 30 of the calendar year during which the exempt status changes to existing borrowers on non-exempt loans outstanding as of July 1 of that year. If a borrower requests escrow, then the escrow account must be established "as soon as reasonably practicable."

One of the issues that cropped up recently is the interplay between this flood small lender exemption and the small creditor exception from escrow requirements on first lien higher priced mortgage loans under Regulation Z. The Reg. Z exception applies to small creditors operating in a rural or underserved area, defined as a lender with less than $2 billion in total assets who does not extend more than 2,000 first lien mortgage loans, excluding portfolio loans, and who makes at least one loan in a rural or underserved area. A small creditor does not qualify for the Reg. Z exception if it escrows for any loan other than a previous higher priced loan where escrow was required under the prior rule or a loan where the escrow is established after account opening as an accommodation to a borrower in distress.

This creates a potential problem for those banks with assets greater than $1 billion, but less than $2 billion. Because a bank with assets greater than $1 billion is required to escrow for flood insurance, it seems that the first time the bank establishes a required escrow for flood insurance, it will lose the benefit of the exception under Reg. Z even if satisfies the other criteria, such the asset and loan tests. The $1 billion threshold in the flood rule is set by statute, so the agencies really had no choice on that point, but it seems they could have done a better job of coordinating their rule writing. We understand the issue has been raised by some trade groups with the regulators and we are hopeful there may be some further change or clarification, but for the moment, we appear to be stuck with the rule as it stands today.

Detached Structures

Flood insurance is no longer required for a structure located on a residential property if it is detached from the primary residence and is not used as a residence. This exemption is provided because the cost of insurance on such a structure could potentially be greater than the value of the structure to the borrower. The determination of whether or not a structure falls within this exemption should be made upon a MIRE event.

For these purposes, a residential property is one that is used for personal, family or household purposes. A structure is detached if it stands alone from the residential structure without a structural connection. The determination of whether or not a detached structure serves as a residence should be made on a case-by-case basis by the lender. Suggested questions for lenders to consider when making this determination are whether or not the structure has bathroom facilities, kitchen facilities, or sleeping quarters. Also, consider when the structure has traditionally used as a residence such as a guesthouse or for some other purpose such as a storage shed or a barn.

Business purpose loans secured by residential property qualify for the exemption. But whether it is a business or consumer purpose loan, a detached structure that is part of a residential property but is used for business purposes is not exempt from insurance coverage because the structure provides value to the bank and to the borrower. It is not the purpose of the loan to consider, but, rather, the purpose for which the detached structure is used.

If a structure was previously exempt and later loses that status, then the lender must notify the borrower that flood insurance is required and if the insurance is not purchased within 45 days, it must be force-placed.

Force-Placed Insurance

If a designated loan has an inadequate amount of flood insurance, then the lender must send notice to the borrower, and if the proper coverage is not obtained within 45 days, then the lender is permitted to force-place coverage and charge the customer beginning on the date on which the borrower's coverage became insufficient. The date on which the coverage became insufficient is considered to be the expiration date on the policy, or the date that the insurance was cancelled.

If the borrower obtains adequate flood insurance coverage and the lender has already force-placed insurance, then the lender is required to refund any premiums paid by the borrower during the timeframe that the policies overlapped. The lender may force-place coverage at any time during the 45 day

period, but it must be placed by the end of the 45 day time frame.

Upon receipt of confirmation from the borrower or the insurer or its agent that the borrower has obtained proper flood insurance, the lender must cancel the force-placed policy within 30 days. Confirmation of the flood insurance is made by providing the declarations page of the insurance policy to the lender. The declarations page must include the existing policy number and contact information for the insurance company or its agent.

We understand FDIC examiners have raised concerns with some banks about the amount of force-placed insurance obtained and whether adding the premium amount to the loan means that the amount of force-placed coverage must cover the total loan balance including the premium. Some questions have been raised, too, about whether adding the premium for force placed coverage to the loan balance is a MIRE event which might trigger escrow requirements or even trigger the need for a new Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance. If that is the case, then, there might also be issues with other events that cause the loan amount to increase, like force-placement of hazard insurance or payment by the bank of delinquent taxes. It is also unclear whether something like a short term payment deferral amounts to an extension for MIRE purposes. No one knows the answers to these questions and the federal banking agencies have not provided any guidance. We know that the American Bankers Association has brought these issues to the attention of the agencies and is seeking clarification. We will be watching developments closely and will pass on any information as soon as we learn of it.

Private Flood Insurance

The Biggert Waters Act of 2012 (BWA) sought to encourage private sector participation in the flood insurance market by requiring lenders to accept private flood policies that meet certain very specific standards. Generally, the policy must provide coverage at least as broad as a standard flood policy, including deductibles, exclusions and conditions, provide for 45 day advance notice to the insured and the lender before cancellation or non-renewal, and contain cancellation provisions that are as restrictive as those in a standard flood policy. This provision of the BWA requires implementing regulations before it becomes effective. The regulators issued a proposal in 2013, but no final regulations have been issued. We suspect this is because the regulators are struggling with how a lender can safely determine whether a private policy meets the rigid standards of the Act. Until final regulations are issued, there is no requirement that a lender accept a private policy, and there is a good reason for a lender to refuse to do so. Unless you are an expert at reading insurance policies and can conclusively demonstrate that the private policy is the equivalent of a standard flood policy in all coverages, deductibles, exclusions, conditions, and cancellation provisions, then you would be at serious risk that the policy does not satisfy the mandatory purchase requirement.

We plan to discuss these issues and more at the quarterly meeting.

(Memrie Fortenberry)

JUST WHO IS A SMALL CREDITOR

The CFPB issued an interim final rule effective March 31, 2016, that increases the number of lenders who qualify for the small creditor exceptions under Reg. Z. While the change is beneficial to many, there may remain some confusion as to who qualifies and what the exceptions really mean. No doubt, that confusion results from multiple changes by the CFPB to the rule over the course of about 6 months.

First, the CFPB amended its small creditor rule last September (with an effective date of January 1, 2016) to increase the origination limit from 500 first lien loans to 2,000 (not including portfolio loans), expand the definition of rural areas to include non-urban census blocks, and extend the temporary Qualified Mortgage balloon loan exception to April 1, 2016, along with some other changes. Then, in December of last year, and prior to the January 1 effective date of the amended CFPB rule, Congress passed the Helping Expand Lending Practices (HELP) in Rural Communities Act which was part of the so-called FAST Act. The HELP Act expanded the definition of small creditor operating in rural and underserved areas and required the CFPB to further amend its rule. This most recent change is particularly important to small creditor lenders who are concerned about the April 1 expiration date of the temporary QM balloon payment exception.

So, after the most recent changes, who qualifies as a small creditor, and what exceptions apply? In this article, we will summarize the qualifications and outline where the exceptions apply and actually make a difference in compliance responsibilities.

Effective March 31, the following requirements must be satisfied in order to qualify as a small creditor under Reg. Z:

- The creditor and its affiliates originated no more than 2,000 first lien covered transactions (consumer closed-end, dwelling-secured loans) during the preceding calendar year that were sold or assigned to another person or subject to a commitment to sell (meaning, portfolio loans do not count for purposes of the 2,000 loan limit); and
- As of the end of the preceding calendar year, the creditor and its affiliates had total assets of less than $2 Billion, adjusted annually for inflation (currently $2.052 Billion).

Also, effective March 31, a small creditor operates in a rural or underserved area if:

- During the preceding calendar year, the creditor extended at least one first lien covered transaction secured by property located in a rural or underserved area, which includes rural and underserved counties identified by the CFPB, census blocks that are not in an urban area as defined by the Census Bureau, and counties and census blocks designated as rural by the Bureau pursuant to an application process. The CFPB publishes a list of rural or underserved counties and offers an automated address search tool on its website.

For applications taken prior to April 1 each year, the look back period for each of those three requirements is either of the two preceding years. Essentially, this establishes a year-to-year grace period so that a lender that met the requirements one year, but not the next, has until April 1 of the following year to come into compliance.

A small creditor operating in a rural or underserved area qualifies for the following exceptions under Reg. Z.

- Balloon payment QM loans. A qualifying small creditor may make a QM loan with a balloon payment. The loan must be for a term of at least 5 years, have a fixed interest rate, provide for substantially equal payments based on an amortization period of 30 years or less, and the creditor must have determined the consumer has the ability to pay the monthly payments and mortgage-related obligations, other than the balloon payment. As a reminder, the temporary balloon payment QM exception only applied to applications received before April 1 and has now expired.
- Balloon payment HOEPA loans. A qualifying small creditor may make a HOEPA high-cost mortgage with a balloon payment. All other HOEPA disclosures and restrictions on terms still apply.
- HPML escrow requirements. A qualifying small creditor is exempt from escrow requirements for first lien higher priced mortgage loans; provided, the creditor does not maintain escrow accounts for any other loans except higher priced loans made at a time when the previous HPML rule required the creditor to escrow (i.e., applications received on or after April 1, 2010 and before May 1, 2016) or loans where the escrow account is established after loan closing as an accommodation to a distressed consumer to help avoid a default or foreclosure.

Also, whether or not any loan was extended in a rural or underserved area, a small creditor that satisfies the loan origination and asset limits may also:

- Originate a portfolio QM loan even if the consumer's DTI exceeds 43% and without regard to complying with Appendix Q;
- Originate a higher priced portfolio QM loan (up to 3.5% above the APOR for first and subordinate lien loans) and receive a compliance safe harbor, rather than a rebuttable presumption of compliance.

While the rule can be complicated, all things considered, the small creditor exceptions provide meaningful relief for community banks. These latest changes are also good news for those small creditors who make balloon loans and were concerned about what to do after April 1.

(Cliff Harrison)

ASSESSING FAIR LENDING RISK

We were privileged to have Everett Fields, Fair Lending Examination Specialist with the FDIC, speak at the February meeting. Everett spoke in some detail about the FDIC's risk-based fair lending exam process following the FFIEC Interagency Fair Lending Examination Procedures. He also pointed us to the Fair Lending Scope and Conclusions (FLSC) Memorandum used by the FDIC to document fair lending risk assessments and conclusions which then may be used to determine the scope of the exam. When discussing how to mitigate fair lending risk, he suggested that one of the first and most important things any bank can do is conduct a periodic risk assessment.

Of course, it makes perfect sense that in order to manage fair lending risk, you have to first understand it – what risks are generated by your bank's lending function, how well do you mitigate those risks, and how do you monitor fair lending performance. Regulators expect a bank to periodically assess its own risk and be able to explain the methodology used and the results. It is virtually a certainty that if you don't perform your own risk assessment, the examiners will. A solid bank risk assessment can pay significant dividends in a fair lending exam making it easier for examiners to assess the bank's fair lending risk and, possibly, limit the scope of their exam.

Your Steering Committee thought it would be a good follow up to Everett's presentation to revisit the subject of fair lending risk assessments. The regulators do not provide much, if any, "how to" guidance on the subject. Everett noted broadly that a risk assessment should evaluate the bank's organizational structure, lending channels, all consumer credit products and services the bank offers, and the collections and loss mitigation areas of your credit operations as well. The FLSC Memo also provides a pretty good outline or checklist for the content of a risk assessment.

Using the Interagency Fair Lending Examination Procedures as a starting place, we developed for the bank group members several years ago a Fair Lending Risk Assessment Guide which included an assessment of each of the following areas and risk factors:

- Bank structure and management, including Board and management support for Fair Lending;
- Compliance Program sufficiency;
- Overt indicators of discrimination;
- Disparate treating in underwriting;
- Disparate treatment in steering;
- Disparate treatment in pricing;
- Disparate treatment in marketing;
- Existence of risk mitigants (e.g., preventive measures such as training, monitoring, independent review, etc.);
- Disparate treatment in collections;
- Fair Lending complaint resolution; and
- Results of regulatory examination and independent review of Fair Lending compliance.

We plan to discuss how to perform a fair lending risk assessment using the Risk Assessment Guide we prepared and the FLSC Memo at the May Quarterly Meeting and talk about some of the concerns and issues we see in performing fair lending reviews and working with our clients on fair lending examinations. As always, please feel free to bring those from your bank that you feel would benefit from hearing this presentation.

(Ed Wilmesherr)

TRID OPEN DISCUSSION

We plan to allow some time at the quarterly meeting to discuss any recent TRID questions or issues you are facing. If you have a question or issue you would like to see discussed or have had TRID related problems (with your software, settlement agents or otherwise) that you would like to share with the group, please let one of us know. Send your questions to Liz, Patsy, Lisa or me as soon as possible so that we can be sure they get addressed.

(*Cliff Harrison*)

MRCG MEETING
TO BE HELD ON MAY 19, 2016

The MRCG will hold its May Quarterly Meeting on May 19, 2016, 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 May meeting, we plan to have a guest speaker from the FDIC who will address some of the thorny issues being raised by some examiners in recent BSA/AML exams, such as monitoring activity of customers with private ATMs, identifying suspicious and unexplained activity and the decision making process to file or not file a SAR. We also plan to have presentations on flood insurance requirements including force placed and escrow requirements, changes to the small creditor exceptions under Reg. Z, and performing a fair lending risk assessment.

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, May 13, 2016, so that arrangements for lunch can be finalized. We look forward to seeing you there.

(*Ed Wilmesherr)*

MSRCG MEETING
TO BE HELD ON MAY 24, 2016

The MSRCG will hold its May Quarterly Meeting on May 24, 2016, 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 May meeting, we plan to have a guest speaker from the FDIC who will address some of the thorny issues being raised by some examiners in recent BSA/AML exams, such as monitoring activity of customers with private ATMs, identifying suspicious and unexplained activity and the decision making process to file or not file a SAR. We also plan to have presentations on flood insurance requirements including force placed and escrow requirements, changes to the small creditor exceptions under Reg. Z, and performing a fair lending risk assessment.

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 Thursday, May 19, 2016, so that arrangements for lunch can be finalized. We look forward to seeing you there.

(*Ed Wilmesherr*)

MRCG-MSRCG COMPLIANCE CALENDAR

10/03/2015 – TRID regulations effective	08/18/2016 – MRCG Quarterly Meeting
01/01/2016 – Flood insurance escrow rules effective	08/23/2016 – MSRCG Quarterly Meeting
01/01/2016 – Reg. Z changes to small creditor serving rural/underserved areas effective	09/15/2016 – MRCG/MSRCG Joint Steering Committee Meeting
03/31/2016 – Reg. Z exception for Small Creditor operating in rural or underserved area effective.	10/03/2016 – DoD MLA consumer credit rules effective
04/01/2016 – Small creditor temporary balloon QM exception expires	11/15/2016 – MSRCG Annual Meeting
04/01/2016 – Deadline to update CRA public file	11/17/2016 – MRCG Annual Meeting
05/02/2016 – Deadline to submit credit card agreements to be posted on CFPB's website. *For issuers not 10,000 or more accounts	01/01/2017 – HMDA exception for low volume depository institutions effective
05/19/2016 – MRCG Quarterly Meeting	10/03/2017 – MLA coverage expands to include credit cards
05/24/2016 – MSRCG Quarterly Meeting	01/01/2018 – Revised HMDA data collection begins
06/30/2016 – Deadline for notices re: option to escrow flood premiums for existing loans	01/01/2019 – Revised HMDA data reporting begins
07/21/2016 – MRCG/MSRCG Joint Steering Committee Meeting	