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Quarterly Report

Mid-South Regulatory Compliance Group

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COMING SOON TO A BANK NEAR YOU – ENHANCED BSA CUSTOMER DUE DILIGENCE RULES

On May 11, 2016, the Financial Crimes Enforcement Network (FinCEN) issued final rules under the Bank Secrecy Act strengthening customer due diligence requirements for banks, securities broker/dealers, mutual funds, futures commission merchants, and commodities brokers. The new rules contain significant customer due diligence requirements which include a requirement to identify and verify the identity of beneficial owners of legal entity customers. Just as significant, the new rules add a new requirement to BSA/AML program requirements for maintenance of risk-based procedures for conducting ongoing customer due diligence. If there is any good news in this announcement, it is that FinCEN recognized that the new rules will present significant compliance challenges and delayed the mandatory compliance date until May 11, 2018, two years after issuance.

FinCEN believes that there are four core elements of customer due diligence that should be explicit requirements in a BSA/AML compliance program. They are:

(1) Customer identification and verification;

(2) Beneficial ownership identification and verification;

(3) Understanding the nature and purpose of customer relationships in order to develop a customer risk profile; and

(4) Ongoing monitoring for reporting suspicious transactions and, on a risk basis, maintaining and updating customer information and the customer risk profile as needed.

The first element, CIP, is already part of every bank's BSA/AML program. The second element will be added by the new rule. The third and fourth elements are already implicitly covered by the BSA/AML program requirement to maintain a system of internal controls to assure ongoing compliance. However, the new rule will add those two elements as a fifth pillar to BSA/AML program requirements.

Beneficial Ownership. Beginning May 11, 2018, covered financial institutions will be required to identify and verify the identity of natural persons who are "beneficial owners" of a new or existing legal entity customer at the time a new account is opened. The term "beneficial owner" includes: (1) any person who owns, directly or indirectly, 25% or more of the equity interests in a legal entity, and (2) a single control person, which is an individual with significant responsibility to control, manage, or direct a legal entity. A control person includes an executive officer such as the CEO, CFO, COO, managing member, general partner, President, Vice President, or Treasurer, or any individual who performs similar functions. A

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financial institution will have to identify and perform CIP on each 25%, or more, owner and at least one control person. Only one control person need be identified and if the control person is also identified as a 25% owner, no additional control person need be identified.

Covered legal entities will include any corporation, limited liability company, limited partnership, or other legal entity that is created by a filing with a secretary of state or similar office, and any general partnership. Some legal entities are exempt including other banks and bank holding companies, registered investment companies, investment advisors, and clearing agencies, publicly-held companies whose stock is registered with the SEC, registered commodities and swaps dealers, insurance companies, and non-US governmental entities that engage only in governmental rather than commercial activities. A few entities, such as pooled investment vehicles and non-profit corporations, are subject only to the control prong and not the 25% or more ownership prong.

Beneficial owners may be identified by obtaining the information on a standard certification form which is provided in the rule. The certification must be obtained from the person opening the account for the legal entity. Financial institutions may use other means as long as the individual opening the account certifies the accuracy of the information. Once identified, CIP must be performed on each beneficial owner following the institution's normal customer identification procedures.

Institutions must retain the information obtained identifying the beneficial owners, including the certification form, for as long as the account is open and for five years after the account is closed. For CIP, a description of the documents reviewed and any non-documentary steps taken or information relied upon to verify the person's identity must be retained for at least five years after the record is made.

BSA/AML Program Requirements. The new rule will also amend BSA/AML program requirements for covered financial institutions to explicitly require risk-based procedures for conducting ongoing customer due diligence. Currently, there are four pillar requirements for a BSA/AML compliance program: (1) designation of a BSA officer, (2) training of personnel, (3) a system of internal controls to assure ongoing compliance, and (4) independent testing. The new rule will create a fifth pillar requiring risk-based procedures for conducting ongoing customer due diligence which must include, at a minimum, the following:

- Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and

- Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, maintaining and updating customer information as needed.

Customer information is not required to be updated on any periodic schedule, but customer information and the customer's risk profile will be required to be updated as needed based on the financial institution's monitoring of suspicious activity.

The new requirement to verify the identity of beneficial owners will place substantial additional compliance burdens on banks when the new rules go into effect. However, the greater risk for banks may be the addition of a fifth pillar program requirement for ongoing customer due diligence. Under the current rules, monitoring for suspicious activity is an implicit part of the pillar requirement for maintaining a system of internal controls. If bank examiners find that a bank's monitoring efforts are inadequate, that could, depending on the circumstances, result in a pillar violation for lack of adequate internal controls. Once the new rules are in place, it appears that deficient suspicious activity monitoring efforts will automatically result in a pillar violation and might also trigger a second pillar violation for lack of adequate internal controls. Multiple pillar violations will result in more severe enforcement action by the regulators.

How the regulators will interpret and apply the new requirements remains to be seen. Examiners already look very closely at a bank's suspicious activity monitoring efforts as part of every BSA/AML examination. In light of the new rules, it seems likely that even greater emphasis will be placed on a bank's monitoring efforts in the future.

(Cliff Harrison)

RECENT ENFORCEMENT ACTIONS PROVIDE A REMINDER

Three recent enforcement actions against banks, each dealing with a different area of compliance, serve as a reminder to all of us that the federal bank regulatory agencies remain vigilant in their efforts to protect the best interests of consumers. A quick look at each of these enforcement actions is instructive.

HSBC Bank USA, N.A.

This was an enforcement action brought by the Comptroller of the Currency that involved charges of unfair practices involving a credit protection product, third-party vendor misconduct, and a failure by the bank to monitor and administer the implementation of this credit product add-on.

In a nutshell, the bank offered a credit protection product to its customers that was marketed and sold by a third-party vendor. To be enrolled in the service, customers had to provide sufficient personal verification information and their consent. This information and consent was not consistently obtained, but customers were still charged the full fee even though in some cases they were not able to access the services.

When confronted with these practices, the bank entered into a Consent Order with the OCC that required the following:

- The creation of a Compliance Committee to oversee the fulfillment of the terms of the Consent Order;
- The establishment of a Comprehensive Action Plan designed to address the problems complained of and prevent any possible recurrence;
- Board of Directors involvement to ensure that the Bank's Senior Management, staff and third-party service providers fully comply with all relevant consumer protection laws and regulations.

The Consent Order further required reimbursement to consumers for unfair billing practices, including a full refund of all fees paid, any over limit charges on credit cards that resulted from fees assessed putting the account over its approved credit limit, and any finance charges assessed on that portion of any account balance.

The bank was required to develop a Reimbursement Plan and monitor the performance of that Reimbursement Plan through the bank's Internal Audit Department.

Perhaps most significantly of all for our purposes, the bank was required to develop a written policy governing the management of third-party vendors, a topic we have talked about at some length in previous meetings. The Consent Order provided a checklist of requirements for such a Third-Party Management Policy that included the following:

- An analysis of the ability of the third-party to perform the marketing, sales, delivery, servicing and fulfillment of its obligations in compliance with all applicable consumer protection laws and regulations;
- The development of a written contract that sets forth all of the duties and responsibilities of each party for issues such as the establishment of internal control, the provision of adequate training, the ability to conduct on-site reviews, and the ability to terminate the contract for failure to comply.

Finally, the bank was required to develop a written, enterprise-wide Risk Management Program for all consumer products offered and to

develop and implement written policies and procedures to effectively manage all consumer risk. An Internal Consumer Compliance Audit Program was also mandated.

Santander Bank, NA

In this enforcement action, the CFPB accused Santander Bank of deceptively marketing its overdraft services to consumers in violation of the "opt-in" Rule in Regulation E.

The CFPB alleged that Santander marketed and enrolled customers in its overdraft services for ATM and one-time debit card transactions, charging a $35 fee per overdraft. The bank used a telemarketer to contact customers to get them to opt-in to the overdraft service and rewarded the telemarketer with higher rates for exceeding specific sales targets.

The CFPB found a number of problems with the marketing of this service. Customers were enrolled in the service without being asked or giving their consent. Customers who declined the service, but requested information, were signed up anyway. In some instances customers were told the service was free, when in fact, significant fees applied. Customers in some cases were given erroneous information about fees that could be incurred if they did not opt-in, and customers were misinformed about the nature and reason for the calls that they received.

Under the CFPB enforcement action, the bank must:

- Contact all customers enrolled in the Overdraft Protection Program and ask them if they wish to opt-in;
- Cease using any third-party vendor to conduct telemarketing of this service; and
- Develop and implement a new or revised policy governing vendor management for telemarketing.

Santander was fined $10 million for the violations.

BancorpSouth

By now everyone has probably read the CFPB's enforcement action and Consent Order involving BancorpSouth. To put the Consent Order in perspective, it needs to be read in conjunction with the Complaint filed by the CFPB. Now, it goes without saying that no Complaint ever tells both sides of the story, and the Consent Order was signed by the bank without any admission of wrongdoing in an effort to avoid future expense and to move on with other important business, but the Complaint and the Consent Order serve as a reminder to us all that the regulators are, and always will be, vigilant with respect to issues of possible discrimination. Discrimination can occur in either overt or unintentional ways, and you always need to be alert. Some of the issues encountered would apply to any bank. We will list these under three headings: (1) redlining; (2) underwriting; and (3) pricing.

Redlining. The CFPB spent a great deal of time analyzing loan data including loans originated, loans declined and differences in results for the bank's loan origination channels.

The CFPB began with an analysis of the bank's CRA Assessment Area as it related to the Memphis MSA. The Complaint contained an extensive analysis of the composition of the Memphis market and the distribution of loans that the bank originated. Suffice to say that a large portion of the bank's mortgage loans were made in non-minority census tracts. The bank's loan origination numbers did not compare favorably to those of its peer bank lenders in that market.

The CFPB examined in depth the bank's process for establishing its CRA Assessment Area and noted that the bank's policy stated that lending in the Assessment Area was the bank's responsibility to its community and that lending outside of the Assessment Area was discouraged. (How many of your banks have a similar statement in your CRA Policy?) The problem was that the bank's CRA Assessment Area, at least for the time under review, excluded almost all minority neighborhoods in the Memphis MSA. Branch

offices were located within the CRA Assessment Area and not in minority neighborhoods. Marketing was directed to higher income census tracts, and almost no marketing was directed to low income or minority tracts. (Again, all of this is per the CFPB. The bank might have a different view.)

The CFPB even took note of a consultant's study that found the Memphis market outside of the bank's Assessment Area to be one of the bank's most favorable areas for branch expansion, and the fact that the bank did not pursue that option was criticized.

CFPB found the totality of these discrepancies to be statistically significant and discriminatory.

Underwriting. Again, the CFPB performed an extensive analysis. In summary, it divided consideration of mortgage lending underwriting into two categories: (1) the bank's Mortgage Department and (2) the bank's Community Banking Department. The distinction largely centered around underwriting using automated underwriting systems for the Mortgage Department and decentralized underwriting using high degrees of discretion in the Community Banking Department.

The CFPB focused in on the Community Banking Department and noted that the bank's General Loan Policy provided only minimal guidance regarding borrower and loan characteristics. According to the CFPB, individual loan officers were given wide discretion. No guidance was provided as to how credit scores should affect underwriting. Wide latitude was given for terms such as loan-to-value, and loan officers were not required to document the reasons for the decisions that they made.

CFPB performed a statistical regression analysis of the bank's mortgage loan application data (think HMDA), using both consumer and business purpose loans. The results showed statistically significant disparities that could not be satisfactorily explained, thus being discriminatory in the mind of the CFPB.

Pricing. Mortgage loan pricing was the third area of statistical inquiry. The focus once again was on the Community Banking Department and its pricing practices. The CFPB again noted that significant discretion was permitted to loan officers when pricing loans. Where the Mortgage Department relied on rate sheets to price loans on a risk-based approach, the Community Banking Department did not rely on rate sheets. The CFPB described the degree of discretion permitted as "unfettered." (The bank would likely disagree.)

The CFPB took note that the bank's General Loan Policy stated that "loan pricing is not an exact science" and listed only "some" of the risk-related factors that should be taken into account. (This language has been standard in loan policies for many years. Does your policy say something similar?)

Again, a statistical regression analysis was performed and the APR's for minority loans were found to be significantly higher statistically than the APR's for non-minority borrowers.

The Complaint goes on, but you can see the trend. Issues like training and the handling of applications were reviewed.

The Consent Order imposed significant penalties and remediation efforts including:

- The hiring of a Compliance Management Consultant to implement an effective CMS System;
- Extensive training for all affected employees;
- The development of a Pricing and Underwriting Compliance Plan;
- The development of pricing policies and monitoring processes;
- The establishment of a Settlement Fund of $2,776,890 to reimburse affected consumers;
- The making of credit offers to certain denied applicants;

- The hiring of an independent consultant to conduct an assessment of the mortgage loan needs of majority-minority neighborhoods in the bank's CRA Assessment Area;

- The opening of a new branch in a minority neighborhood;

- The establishment of a $4 million loan subsidy program;

- The annual expenditure of $100,000 devoted to marketing in minority markets; and

- Last, but not least, a Civil Money Penalty of slightly more than $3 million.

Conclusion. The thrusts of these enforcement actions are nothing new. Deceptive marketing practices, vendor management issues, overdraft practices and Fair Lending are all topics that we have discussed in prior meetings at great length. The advice offered in those prior meetings remains unchanged. You must be on top of the practices that your vendors engage in. Offering financial incentives based on sales results is likely to get you into trouble. Monitor your vendors and have a written contract that requires them to fully comply with all consumer protection laws and regulations and gives you full access to review their performance.

The Fair Lending enforcement action was unique only in that it dealt with both redlining, loan underwriting and loan pricing in one action. Most prior enforcement actions focused only on one of these issues. Again, we have addressed all of these fair lending issues in prior meetings, and again, the advice remains much the same. You need to be fully aware of what your loan data reveals. The determination of your CRA Assessment Area is critical, as is your level of performance as compared to your peer lenders. Discretion in loan underwriting and loan pricing is very problematic. Your goal should be consistent policies and procedures which produce consistent results. Then, these results need to be monitored. Everything the bank does, e.g., training, marketing, etc., needs to reflect a culture of Fair Lending.

(Ed Wilmesherr)

MLA EXPANSION EFFECTIVE OCTOBER 3, 2016

In 2015, the U.S. Department of Defense (DoD) issued final rules greatly expanding the scope of its Military Lending Act (MLA) regulations. The MLA imposes an interest rate limit on extensions of consumer credit made to covered borrowers, restricts certain terms, and requires certain disclosures be made by lenders extending consumer credit to covered borrowers. The new rules which first become effective October 3, 2016, expand the scope of consumer credit covered by the rules and change the safe harbors available to lenders for determining whether or not a borrower is a covered borrower for purposes of the MLA. There are still some uncertainties about the application of the new rules, and bank trade associations have continued to urge DoD to issue further clarifications. In this article and at the quarterly meeting, we will review the new requirements and discuss some of the problem areas which exist.

Coverage. The existing regs limit covered consumer credit to short term, low dollar payday type loans; short-term vehicle title loans; and tax refund anticipation loans. Under the new rules, the definition of "consumer credit" is greatly expanded to include all types of consumer credit covered by Regulation Z/Truth-in-Lending with only a couple of exceptions. The final rules cover any extension of credit for personal, family or household purposes to a "covered borrower" that is subject to a finance charge or payable by written agreement in more than four installments.

Excluded from coverage are residential mortgages (defined for purposes of this rule as any loan secured by a 1 to 4 family dwelling, whether or not attached to real property); purchase money automobile and personal property transactions secured by the auto or property being purchased,

loans in an amount above the Reg. Z coverage threshold (currently, $54,600), and loans for a business purpose excluded from coverage under Reg. Z.

So, the new rules apply to most consumer purpose loans including installment loans, personal lines of credit, loans secured by a car or boat that are not purchase money, student loans and lot loans (real property with no dwelling). Open-end credit, such as a credit card account, was previously exempt under the MLA, but open-end credit, including credit card accounts, are no longer exempt. However, the new rule does not apply to credit card accounts until October 3, 2017, with the possibility of an additional one year extension to be considered later by DoD. That one year deferral only applies to open-end, not home-secured credit card accounts. Other types of open-end consumer credit are covered beginning October 3, 2016.

Covered Borrower. The new rules apply only to "consumer credit" extended to a "covered borrower" which is defined as any member of the armed forces on active duty or on active Guard and Reserve duty, and their dependents. Dependents can include the spouse and child, and in some cases, a parent or parent-in-law or an unmarried person in the legal custody of the servicemember. The existing rule provides a safe harbor for a lender in making the covered borrower determination by obtaining the borrower's self-certification in a Covered Borrower Identification Statement. Self-certification may continue to be used, but will no longer qualify for a safe harbor beginning October 3, 2016. However, the new rules make two new safe harbors available.

Lenders may conduct a covered-borrower check by using information obtained from the DoD's database or from information contained in a consumer report from a nationwide consumer reporting agency. If a lender uses one of these sources and complies with the timing and recordkeeping requirements in the rules, then a safe harbor is granted. From a timing standpoint, in order for the safe harbor to be available, the creditor must make the determination solely at the time the covered borrower "initiates" the transaction or applies to establish the account, or 30 days prior, or when the creditor develops a "firm offer of credit" (for example, in a prescreened solicitation). That language creates a problem for any lender who does not make the determination until sometime after the initial loan application is taken. The lender must also make a contemporaneous record of the determination for the safe harbor to be available.

DoD was concerned about a large number of users having direct access to its database and required those interested in obtaining direct access to register. Selection was based on anticipated volume, and it is expected that only the largest institutions and the three nationwide consumer reporting agencies will have direct access, although information is still available to other users via the DoD MLA website which allows for individual and batch inquiries. Recent reports indicate that the three nationwide consumer reporting agencies are in the process of testing their interfaces with the DoD system. It has also been reported that the credit reporting agencies will not be able to provide status information for dependents under 18 (for student loans, for example), and lenders needing that information likely will have to obtain it via the DoD MLA website.

MAPR. Consumer credit to a covered borrower is limited to a 36% Military Annual Percentage Rate (MAPR), which is an all-inclusive rate and includes many charges that would otherwise be excluded from the finance charge and APR under Reg. Z. The final rule provides some guidance in calculating the MAPR and eliminates some prior finance charge exceptions. For closed-end credit, the MAPR is calculated in the same way as the APR under Reg. Z except that it must also include, in addition to finance charges, any charges for credit insurance, debt cancellation or suspension products, application fees, participation fees, and fees for any ancillary products sold in connection with the credit extension. Presumably, those items that are paid up front would be treated like

prepaid finance charges under Reg. Z for purposes of computing the MAPR.

The MAPR for open-end credit is calculated in the same way as the effective APR for a billing statement under Reg. Z and includes all of the fees included for closed-end credit. As a result, fees other than periodic interest may be severely limited in any billing cycle where the account has a low balance, and the rules prohibit charging any fee during a billing cycle where there is no balance on the account, with an exception for a participation fee not in excess of a total of $100 per year. In addition, the rules exclude from the MAPR certain "bona fide" fees on a credit card account which may cover fees other than a periodic interest rate, such as participation fees, cash advance fees, or other transaction-based fees provided the fee is both bona fide and reasonable.

Reasonableness is determined by comparing the fee with fees typically imposed by other creditors for a similar product. A safe harbor is provided for a fee that is not more than the average amount charged by 5 or more creditors who have U.S. credit cards with outstanding balances totaling at least $3 billion at any time during the 3-year period preceding the time the average is computed. The exclusion of bona fide credit card fees does not apply to any charges for credit insurance, debt cancellation or debt suspension fees, or fees for any credit related ancillary product sold in connection with the account. And, if a creditor charges any fee that is not bona fide or reasonable in addition to a finance charge included in the MAPR, then the total amount of all fees must be included in the MAPR including any that might otherwise be considered to be bona fide and reasonable. So, charging a single fee that is not bona fide and reasonable will cause even bona fide and reasonable fees to be included in the MAPR computation.

Disclosures. Disclosure requirements were amended in several ways. First, the requirement for clear and conspicuous disclosures was removed. Second, the final rule simplifies the information a creditor must provide. In addition to disclosures required by Reg. Z, a creditor must provide a statement of the MAPR that describes the charges the creditor may impose, but the creditor will no longer be required to provide an actual, computed MAPR or the total dollar amount of the charges included in the MAPR. Instead, the final rule provides a model statement describing the MAPR, and a creditor may use the model statement or a substantially similar statement. Also, the requirement for creditors to provide a specific statement regarding protections available under federal law was removed.

The creditor must also provide a clear description of the payment obligation, which can be satisfied by using the payment schedule or account-opening disclosures under Reg. Z. In addition to written disclosures, the creditor must provide orally the statement of the MAPR and the description of the payment obligation. However, a creditor may now provide the oral disclosures either in person or by providing a toll-free number the borrower may use to obtain the disclosures. If the creditor elects to provide a toll-free number, it must include that number on the application form or with the statement of the MAPR.

Limitations and Prohibitions. The new rule follows the Military Lending Act and makes it unlawful for any creditor to extend consumer credit to a covered borrower which contains certain terms. Creditors are prohibited from the following:

- Rolling over, renewing, refinancing or consolidating any consumer credit extended to the covered borrower with the proceeds of new covered consumer credit by the same creditor. This prohibition is limited to deferred presentment or similar payday loan transactions and does not apply to a bank, savings association or credit union.
- Requiring a covered borrower to waive any right of recourse available under state or federal law, including the SCRA. Right of recourse is not defined and there is some risk that boilerplate waivers of notice or other defenses that are common in many form notes and credit agreements may violate this prohibition. A review of loan forms may be

in order, and it may be wise to consult with your loan platform system provider about form changes or suppression of certain terms for loans to covered borrowers.

- Requiring covered borrowers to submit to arbitration or other onerous legal notice provisions in the case of a dispute. "Onerous legal notice" is not defined, but it is pretty clear that mandatory arbitration and class action and jury trial waivers would be prohibited in a consumer loan to a covered borrower. It is not clear how this prohibition might apply to an arbitration clause contained in a third party product sold by a lender, such as credit life insurance.
- Demanding unreasonable notice from the covered borrower as a condition for legal action.
- Using the title to a vehicle as security for a loan. This restriction does not apply to a bank, savings association or credit union.
- Using a check or other means of accessing a deposit account of a covered borrower. However, a creditor may require an electronic transaction to repay the consumer credit if not otherwise prohibited by law. A creditor may also require direct deposit of salary as a condition of extending credit, unless otherwise prohibited by law. A creditor may also take a security interest in funds deposited, but only in funds deposited after the extension of credit or opening of the open-end credit account in a deposit account established in connection with the extension of credit. This effectively prohibits any loan secured by an existing CD or savings account.
- Requiring use of an allotment to repay the obligation, with a limited exception for a loan made by a "military welfare society" or "service relief society."
- Imposing any prepayment penalty on covered consumer credit. The rule does not define what constitutes a prepayment penalty. The original 2007 rules applicable to payday, vehicle title and refund anticipation loans, also prohibited any prepayment penalty. In issuing that rule, DoD said lenders should look to other law for guidance. This vagueness may create an issue for some lenders. For example, Reg. Z considers a minimum interest charge on a simple interest transaction and a rebate of unearned interest using the Rule of 78s method on a precomputed loan as a prepayment penalty for some purposes.

Penalties. Penalties for non-compliance have been increased and are potentially severe. Any note or credit agreement which fails to comply or which contains a prohibited provision is deemed void from inception. The use of the word "contains" has caused some concern among lenders and forms providers. The fear is that any note or credit agreement that contains a prohibited provision is void even if the document expressly waives that provision with respect to covered borrowers. As a result, some lenders and forms providers are creating separate loan forms or are suppressing certain provisions so they do not print on a loan to a covered borrower.

Any arbitration provision is unenforceable. Also, creditors may be exposed to civil liability for violations including actual damages but not less than $500 per violation, punitive damages and equitable or declaratory relief as allowed by a court, along with reasonable attorneys' fees and expenses. Actions may be brought in federal court without regard to the amount of the claim and may be brought within 2 years after the date of discovery of the violation or 5 years after the actual violation, whichever is earlier. Similar to Reg. Z, the rules provide for a bona fide error defense if the lender can prove that the violation was unintentional and resulted from a bona fide error despite the fact that the creditor maintained reasonable procedures to avoid such errors. Criminal penalties are provided for knowing violations.

Effective Date. While the new rule was made effective as of October 1, 2015, it only applies to consumer credit transactions with a covered borrower entered into on or after October 3, 2016. In addition, credit card accounts are not included in the definition of "consumer credit" until October 3, 2017. However, the civil liability

provisions apply to consumer credit extended on or after January 2, 2013.

The American Bankers Association and other trade groups have continued to urge DoD to further clarify certain aspects of the rule and resolve some of the problem areas before compliance becomes mandatory. We will continue to monitor developments as the October 3 compliance date approaches.

(Memrie Fortenberry)

GUIDANCE ON DEPOSIT RECONCILIATION ISSUED

In May, the CFPB, FDIC, OCC, Federal Reserve and NCUA issued joint guidance on deposit reconciliation practices of financial institutions. The guidance discusses the agencies' supervisory expectations for how financial institutions handle discrepancies between the amount of credit given for a deposit and the actual total of the items deposited. This kind of discrepancy arises in a number of different ways, such as a customer error in completing a deposit slip, an encoding error, or poor image capture. Errors may go in either direction and favor the customer when the institution gives credit for a greater amount than the actual total of the items deposited, or favor the bank when the credit given is less than the actual total of the items. It is this latter type of error, called a "credit discrepancy" that the agencies are concerned about.

The agencies said that financial institution practices that do not appropriately reconcile credit discrepancies may run afoul of the Expedited Funds Availability Act (EFAA) and Regulation CC as well as the FTC Act and the Dodd-Frank Act prohibitions against unfair, deceptive, or abusive acts or practices. The EFAA and Reg. CC require that funds deposited to a transaction account be made available for withdrawal within specified time limits. For most deposits, that means by the opening for business on the next banking day. Failure to appropriately reconcile credit discrepancies within the prescribed timeframe may violate Reg. CC if the result is that the customers do not have timely access to the correct amount of funds. Failure to reconcile credit discrepancies may also create an unfair, deceptive, or abusive act or practice, depending on the circumstances.

The agencies' view is that technological and other processes exist that allow financial institutions to fully reconcile discrepancies in deposits. They did recognize, however, that it may not be possible to reconcile discrepancies in some limited circumstances, such as where an item is damaged to the point that its true amount cannot be determined.

This guidance follows on the heels of a joint enforcement action in 2015 by the CFPB, OCC, and FDIC against Citizens Bank in Pennsylvania over the deposit reconciliation practices of Citizens and its affiliated banks. The bank employed a de minimis amount for deposit reconciliation. If the amount of the discrepancy was $50 or less, the bank made no effort to reconcile the differences. At some point during the five-year period under review (2008 to 2013), the bank lowered its threshold to $25. Discrepancies worked in the favor of some customers and to the detriment of others. As a result of the enforcement action, the bank was required to change its practices and make restitution to all consumer and business customers who did not receive the full amount of their deposit. The bank was also required to refund any related overdraft, maintenance or service fees plus interest on the total refund. Total restitution was in excess of $11 million, and the bank was also required to pay a total of $20.5 million in civil money penalties to the CFPB, OCC and FDIC.

A bank that employs even a low de minimis for deposit reconciliation may need to rethink its practices. The interagency guidance never says that use of a de minimis or threshold amount is prohibited. Instead, the agencies emphasized that customers should be given complete credit for the full amount of their deposit and that institutions have the capability for full reconciliation except in very limited circumstances where reconciliation is

simply not possible. UDAP issues may arise from documents and disclosures given to deposit customers that may imply that deposits are fully reconciled. For example, a Reg. CC disclosure must disclose the bank's funds availability policy, and deposit account agreements often state that deposits are subject to verification. Without more, those documents may imply that deposits are fully reconciled and if a bank does not fully reconcile all deposits, regulators may view the institution as making deceptive statements to its customers.

(Virginia Wilson)

THE CFPB PROPOSAL ON ARBITRATION

The CFPB continues to flex its muscle when it comes to protecting consumers. One of the most recent steps involves the widespread use of arbitration agreements.

Arbitration is a practice that has been utilized in the past with different frequency based on the perceived risk of litigation and the possibility of damaging jury verdicts. Mississippi was one jurisdiction where litigation risk was at the highest. In the latter part of the 1990s courts in Mississippi began allowing "mass joinder" of claims which, simply put, allowed one customer located in a "favorable" county to file suit against the bank and "join" all of the bank's customers in that one suit. This practice led to forum shopping and, in some cases, alarming jury verdicts.

The U.S. Supreme Court cleared the way for banks to use arbitration agreements when it ruled that the Federal Arbitration Act applied to any contract that affects interstate commerce. All of banking affects interstate commerce.

An arbitration agreement, in its simplest form, is simply a contract between the bank and its customer that says when a dispute arises either party can require that the dispute be sent to arbitration rather than be litigated. Such an arbitration has many advantages. One or more arbitrators will hear and decide the matter, not a jury. The dispute can be disposed of in a matter weeks, not years. The result can be kept confidential. These proceedings are generally less expensive. These are just a few of the advantages.

One big advantage has been the ability to eliminate class actions by adding a provision that says only individual claims can be asserted. That also did away with "mass joinder" of claims. It is this feature that the CFPB is focused upon.

The Dodd-Frank Act charged the CFPB with studying the use of arbitration agreements in a consumer setting and empowered the CFPB to take such steps as it deemed necessary to protect the best interests of consumers.

In a proposed rule, the CFPB has moved to prohibit the use of arbitration agreements that contain clauses that prevent class actions. Under this proposal you would still be able to include an arbitration agreement in your consumer contracts; however, those arbitration agreements would have to explicitly state that the arbitration agreement cannot be used to stop consumers from taking part in a class action.

Based on the study conducted, the CFPB believes that this proposal would benefit consumers in several ways. It would let consumers join a large number of small claims against a single company or bank and have all of these claims resolved in a single class action. It would provide a deterrent to banks and other businesses that might not be so concerned about individual small claims, and it would encourage businesses in similar lines of business to abide by consumer protection laws and regulations based on litigation against their competitors that are engaged in similar practices or offer similar products. And finally, the CFPB believes that it will benefit consumers when banks and other businesses are forced to report the results of arbitrations, as the proposal requires.

Some proponents of arbitration have examined the CFPB's report and feel that the research performed does not support the conclusions reached or the actions taken by the CFPB. It is possible that this proposed rule may be challenged

for not meeting the level of justification needed to support the proposed action in compliance with the Dodd-Frank Act. We will have to wait and see.

For now, arbitration is still a viable process for most consumer complaints. It may continue to be useful, especially in non-consumer contracts and disputes. Once the final rule is released, things should be clear. If the CFPB prevails in its proposed course of action, the risk of class actions will, of course, rise.

(Ed Wilmesherr)

CFPB PROPOSAL ON PAYDAY AND CERTAIN HIGH-COST INSTALLMENT LOANS

The CFPB has proposed rules to address certain forms of consumer credit often utilized by low-income individuals for emergency or other funding needs.

This proposed rule would apply to two types of loans. First, it would apply to short-term loans with a term of 45 days or less (typical payday loans) and short-term vehicle title loans. That part of the proposed rule may have little or no impact on a bank's loan practices. However, the second part of the proposed rule would apply to longer-term loans of more than 45 days that have (1) a total cost that exceeds 36%; and (2) either a lien on a consumer's vehicle or a "leveraged payment mechanism" that gives the lender direct access to the consumer's account for payment purposes. Conceivably this second proposal could impact banks that have a finance company subsidiary or banks that make small loans using a state's "Parity" statutes and rates available to small loan licensees as the "most favored lender" in that state.

Several types of credit would be excluded such as:

- Loans to purchase automobiles or other consumer goods;
- Home mortgages;
- Credit cards;
- Student loans;
- Overdraft services; and
- Lines of credit.

Key to the entire approach is a new form of Ability to Repay Rule. For "covered" short-term loans and certain longer-term loans a lender would have to determine that the consumer has the ability to repay the debt incurred using the consumer's net income, housing costs and other expenses, debt obligations, etc.

Limits would be placed on the number and frequency of these loans to a single borrower, and new rules would apply to the methods that could be used to obtain repayment.

Whether this proposed rule has a significant impact will be determined by its final scope and terms. We will continue to monitor this new proposal and keep you informed.

(Virginia Wilson)

MRCG MEETING TO BE HELD ON AUGUST 18, 2016

The MRCG will hold its August Quarterly Meeting on August 18, 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 August meeting, we will discuss in detail newly proposed enhancements to the Customer Due Diligence Rules, as well as related BSA issues. Also, we will cover three recent enforcement actions involving Fair Lending, UDAAP claims, and vendor management issues. Additional topics: expansion of Military Lending Act rules, guidance on deposit reconciliation, and CFPB proposed rules dealing with Arbitration and Payday and High-Cost installment loans.

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 12, 2016, so that arrangements for lunch can be finalized. We look forward to seeing you there.

(Ed Wilmesherr)

MSRCG MEETING TO BE HELD ON AUGUST 23, 2016

The MSRCG will hold its August Quarterly Meeting on August 23, 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 August meeting, we will discuss in detail newly proposed enhancements to the Customer Due Diligence Rules, as well as related BSA issues. Also, we will cover three recent enforcement actions involving Fair Lending, UDAAP claims, and vendor management issues. Additional topics: expansion of Military Lending Act rules, guidance on deposit reconciliation, and CFPB proposed rules dealing with Arbitration and Payday and High-Cost installment loans.

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, August 18, 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	08/23/2016 – MSRCG Quarterly Meeting
01/01/2016 – Flood insurance escrow rules effective	09/14/2016 – Comments due on CFPB proposed rule on payday, title and high cost installment loans
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
06/30/2016 – Deadline for notices re: option to escrow flood premiums for existing loans	10/03/2017 – MLA coverage expands to include credit cards
08/10/2016 – Comments due on CFPB proposed rule on annual privacy notices.	01/01/2018 – Revised HMDA data collection begins
08/18/2016 – MRCG Quarterly Meeting	05/11/2018 – FinCEN BSA enhanced customer due diligence rules effective
08/22/2016 – Comments due on CFPB proposed rule on arbitration agreements	01/01/2019 – Revised HMDA data reporting begins