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# Quarterly Report

Mid-South Regulatory Compliance Group

May 2017 Vol. 14 No. 2

## UDAAP UPDATE

For several years now, we have been talking about activities defined as unfair, deceptive or abusive according to the Consumer Financial Protection Bureau (CFPB). We keep harping on the subject because the CFPB, and the other federal banking agencies, continue to take this very seriously. The Consumer Financial Services Committee of the American Bar Association (ABA) prepared a survey of recent enforcement actions and plans to update it on a periodic basis. The purpose of the survey is to create a better understanding of the activities that are deemed unfair, deceptive or abusive by the CFPB. This article is a summary of the ABA's survey.

According to the ABA, there were at least 11 enforcement actions involving alleged unfair, deceptive or abusive acts and practices between July 1 and December 31, 2016. Of these eleven actions, four involved banks. The others involved a credit repair company, an online lending company, a student loan lender, an auto title lender, a credit union, a debt collection company, and a payday lender. Though most of the recent enforcement actions weren't against banks, there are lessons to be learned from all of them. The allegations included, among others, deceptive practices regarding overdraft services, unfair and deceptive practices related to add-on products, unfair and deceptive practices related to the marketing and servicing of student loans, unfair and deceptive debt collection practices, deceptive practices regarding fees charged on tax-refund checks and treatment of past due accounts. These companies reimbursed customers in amounts ranging between $250,000-$5,000,000 and paid civil money penalties ranging from $250,000-$100,000,000.

It is more difficult to pinpoint activities that are considered abusive because that standard hasn't been used for as long as deceptive and unfair. Two of the recent enforcement actions included allegations of abusive acts and practices. The first of these enforcement actions was against Wells Fargo. There, the CFPB alleged that the bank opened unauthorized credit card and deposit accounts without consumers' knowledge. It was also alleged that customers were enrolled in online banking without their knowledge and were issued debit cards without consent. The CFPB claimed the bank took advantage of consumers who did not have an opportunity to protect themselves and choose their own financial products and services. The CFPB further stated that customers enrolled into products and services without consent did not have the ability to read or fully understand the terms and conditions of such products and services and such treatment is abusive.

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The second enforcement action that included allegations of abusive acts and practices was against TMX Finance, LLC, which offers short-term automobile title loans. The company made multiple renewals or extensions available on some loan types. The company used a guide in its sales pitches that included examples of multiple loan renewals or extensions. The guide disclosed the finance charge and principal paid for each 30-day renewal period but did not disclose the total cost of the transaction. This practice was deemed abusive by the CFPB because the guide interfered with consumers' ability to understand the terms and costs of the credit such as: the loan contemplated was a 30-day transaction, the guide was not an actual repayment plan, and any renewals and extensions changed the total cost of the transaction and increased the cost of the credit. The company was also accused of unfair debt collection practices by making in-person visits to consumers' homes and offices and exposing the existence of the debt to third parties.

The remaining enforcement actions involved unfair and deceptive acts and practices regarding overdrafts, credit card add-on products, student loans, debt collection and credit repair services, and automobile and other consumer loans.

Overdrafts. Two recent enforcement actions addressed unfair and deceptive practices related to overdraft services. In one, the CFPB alleged that employees of a bank made misleading statements regarding its overdraft practices including that no fees would be charged for overdraft services when the service actually did carry fees or that only one fee would be charged either on the day of the overdraft or on the sixth day after when charges were actually imposed at the time of both events; that the customer would not be charged if the overdraft was repaid in five days when this was not a true statement as charges were imposed on the day of the overdraft; that fees for the service would only be imposed in emergency situations but fees were actually charged in all situations; and that customers would be charged overdraft and other fees if they did not opt-in to the service. The CFPB also alleged that the telemarketers misrepresented the reason for making the calls by claiming that the purpose was either to re-enroll the customer or inform the customer of his or her opt-in status. It was also alleged that telemarketers led customers to believe that overdraft services would apply to all transactions when the solicited services only applied to certain transactions including ATM and one –time debit transactions.
More recently, in January of this year, the CFPB filed suit against another bank for misleading its customers regarding opt-ins for overdraft services. The CFPB alleged that the bank provided its employees with scripts used to persuade customers to opt-in to overdraft services at the time the customer had to agree to other mandatory items at account opening. The script did not include any language informing the customer that the opt-in was optional. A separate script was allegedly used for existing account holders through which bank employees were instructed to ask customers if they wanted their debit card to continue to work "as it does today" without explaining that consent would allow the bank to charge overdraft fees which may not have otherwise been charged. If a customer asked for more information, employees were instructed to give an example of an emergency situation in which a customer would desperately need access to money rather than a more common example.

Credit card add-on products. Many of the alleged marketing violations relating to credit card add-on products resulted from internal policies encouraging or requiring the sale of a certain number of services in order to meet a set sales quota. It is very important to ensure that any incentive program implemented at your bank does not require or encourage employees to sell products to customers who won't benefit from them. The overdraft enforcement actions

provide some examples of inappropriate marketing techniques, but more follow here.

Similar to the overdraft telemarketing calls, a bank was accused of deceptive practices in telemarketing efforts to enroll customers in a debt cancellation product by misrepresenting the nature of calls. The CFPB said bank employees informed consumers that the purpose of the call was to say "thank you" by offering the consumer a new account feature. Employees of this bank also allegedly implied to customers that listening to a sales pitch for the add-on product was a requirement of card activation. The CFPB also alleged that bank employees misrepresented the enrollment and cancellation processes as well as the terms, exclusions and benefits of the product. For example, telemarketers would allegedly enroll customers into a product without telling them that a purchase was required and send consumers a welcome kit "for review" or would ask the customer to verify specific information such as their city of birth as approval for enrollment. Further, it was alleged that telemarketers did not inform consumers of eligibility requirements and enrolled ineligible customers into products without obtaining the necessary information to make an eligibility determination.

One bank allegedly increased employee compensation in return for preventing consumers from cancelling or allowing cancellations only after multiple demands by consumers when these employees had actually been instructed to inform customers that enrollment could be cancelled immediately upon request and at any time without question.

It was further alleged that this bank also attempted to prevent consumers from obtaining promised benefits from debt cancellation products by imposing strict conditions that were not disclosed prior to enrollment such as excluding coverage for incidents that occurred before the purchase and six months after enrollment. The Bank also allegedly imposed burdensome administrative requirements including strict waiting periods and requiring multiple continuation forms with complicated timing requirements before unemployment benefits were provided.

Student Loans. Wells Fargo was also accused of deceptive practices in relation to student loans which lead to increased costs and unfair penalties to borrowers. There, the CFPB alleged that bank employees misrepresented to student borrowers that paying less than the full amount due on any billing cycle would not satisfy any obligation owed to the bank when that was not the bank's policy with respect to treatment of partial payments. The lender was also accused of unfair handling of late payments and partial payments and the unfair assessment of fees. The CFPB alleged that the bank charged late fees when payment was made on the last day of a customer's grace period. It was further alleged that when a customer made multiple partial payments in one billing cycle instead of a lump sum payment, the bank would not aggregate these payments when that would have allowed the customer to meet an entire obligation. The bank also allegedly failed to disclose its payment allocation methods and applied payments in a manner that increased late fees. Finally, the bank was also accused of failing to update and/or correct information that was reported to credit reporting agencies incorrectly.

A private student loan lender was required to pay an $8 million civil money penalty and $23.5 million in consumer redress for allegedly telling customers that their loans could be repaid in monthly payments of as little as $25 when most of the average payments were in greater amounts.

Debt Collection Practices/Credit Repair Services. A credit union and a debt collection company were both accused of deceptive debt collection practices for allegedly making false threats of legal action such as arrest, imprisonment, and wage garnishment against

delinquent borrowers when the companies had no intention of actually taking such actions. The credit union, Navy Federal, also allegedly threatened to contact a member's commanding officer upon failure to pay. The credit union employees also allegedly told customers that if they were behind on a loan, they would not likely ever be able to get another loan with any other lender. The CFPB also accused the credit union of unfair treatment for freezing members' deposit accounts upon delinquency on a loan which led to consumers losing access to their debit cards and online banking.

A credit repair company allegedly engaged in deceptive practices by failing to properly disclose fees. Customers were charged an automatic monthly fee if the services were continued beyond an initial 60 day period; however, customers were not informed of an existing option to cancel without being charged. The company also allegedly failed to disclose specific limits on its "money-back guarantee" policy that required customers to pay for at least six months of services in order to be eligible for the guarantee. And, finally, the CFPB alleged that the lender falsely informed customers about the benefits of credit repair services offered by the company. The company wrongly informed customers that use of its product would likely lead to the removal of negative information on credit reports and an increase in credit scores.

Automobile and other Consumer Loans. A payday loan and check cashing company was accused of advertising tax-refund check cashing services for $1.99 when the fee imposed was actually 1.99% of the customer's refund. The CFPB also accused the same company of threatening unsecured borrowers with repossession of their cars.

Unfair, deceptive and abusive are broad and vaguely defined standards of conduct, and there is no clear brightline test or checklist to go by. The best source of guidance may well be enforcement actions and examiner actions where we all can learn from the experiences of others. We hope these examples will help as you continue to review new and existing products and services, marketing materials, policies and employee manuals.

(Memrie Fortenberry)

## DOING BUSINESS WITH YOUR INSIDERS

We have received Regulation O questions with increasing frequency, so—by popular demand—this article is a brief refresher on some important considerations when banks do business with their directors, officers, and principal shareholders. Reg O addresses extensions of credit to a bank's directors, officers, and large shareholders, but other state and federal law applies to all transactions with directors and officers. Banks should remain cognizant of each of these when doing business with their officers, directors, and large shareholders, and so should those individuals.

Reg O governs extensions of credit to executive officers, directors, and principal shareholders and to extensions of credit to any company controlled by such a person or to a political or campaign committee that benefits or is controlled by such a person. Reg O's reach includes transactions like overdraft advances, letters of credit, increases of existing indebtedness, and repurchase agreements along with ordinary loan transactions and other things. Reg O does not apply to transactions that are not extensions of credit.

Primarily, Reg O requires that transactions under its purview be subject to the bank's ordinary underwriting analysis, be on the same terms as are available to other customers, and—with some exceptions—be subject to approval by the board of directors (other than a director involved in the transaction). Some other restrictions apply as well, such as lending limits.

One common Reg O question relates to overdrafts. Reg O prohibits paying an overdraft of an executive officer or director on an account of the bank, unless the payment of funds is made in accordance with a written, pre-authorized, interest-bearing extension of credit plan that specifies a method of repayment or with a written, pre-authorized transfer of funds from another account at the bank. This prohibition does not apply to payment of inadvertent overdrafts in aggregate amounts of $1,000 or less provided that the account is not overdrawn for more than five business days, and the bank charges the executive officer or director the same fee charged to any other customer of the bank in similar circumstances. Understandably, bank employees may cringe at the thought of returning a director's check that would create an overdraft over $1,000 as required by Reg O. For this reason, officers and directors may be well-served to tie their personal checking accounts to a separate account or line of credit to make sure the bank does not become obligated to return an inadvertent overdraft exceeding $1,000. Banks should also be careful to avoid the temptation to waive overdraft charges for directors and officers since Reg O requires that they be assessed and not refunded.

Another common question is Reg O's application to an existing bank customer that joins the bank's board or becomes a principal shareholder or executive officer. In these circumstances, a loan may have been made to the individual before Reg O applied to that individual. Banks should be careful when renewing or modifying existing extensions of credit of this sort because they are subject to Reg O once the individual becomes subject to Reg O.

Outside of Reg O, the Dodd-Frank Act added a new restriction in the Federal Deposit Insurance Act for purchases and sales of assets to insiders and related people. Transactions of this sort must be on market terms and—for transactions exceeding 10% of the bank's capital stock and surplus—must be approved by majority of the disinterested members of the board. Examples of transactions subject to this obligation include things like the sale of ORE property to a director and the purchase of real estate from a director for future expansion.

Under state law, directors and officers owe fiduciary duties to the bank and its shareholders, including a fiduciary duty of loyalty. Simply put, the duty of loyalty obligates a director to put the bank's interest before individual interests. The duty of loyalty does not prohibit insiders from doing business with the bank they serve, but it does require them to make sure any transaction with their bank is fair to the bank and its shareholders. Breaches of the duty of loyalty can subject directors to personal liability to shareholders.

States' laws differ, and the corporate laws of the state where your bank or holding company is organized will apply to you. National banks are governed by federal law, supplemented by the corporate laws of the state where the bank is headquartered. State conflict of interest laws generally provide procedures when an insider enters into a transaction with the bank, and these laws are not always intuitive. For example, in a conflict of interest situation under Mississippi law, a vote of the so-called "qualified" directors is often appropriate. Mississippi's definition of qualified directors is not consistent with either Reg O or Dodd-Frank. So, on an ordinary board of directors of a Mississippi bank that seeks to vote to approve a director's transaction with the bank, Reg O and Mississippi law may result in different lists of directors that are permitted to vote. Also, Mississippi law would prohibit non-qualified directors from even being present for board deliberations, as opposed to "abstain[ing] from participating directly or indirectly in the voting" pursuant to Reg O.

(Jeff Stancill)

## CFPB PROPOSES AMENDMENTS TO 2015 HMDA RULE

The January 1, 2018 effective date of expanded data collection under the 2015 Home Mortgage Disclosure Act (HMDA) rule is fast approaching. On April 13, the CFPB issued proposed changes to the rule containing a number of clarifications, technical corrections and minor changes, most of which would take effect in January 2018 assuming the proposal is finalized. Comments on the proposal are due by May 25, 2017, 30 days after publication in the Federal Register (82 FR 19142).

The Bureau says the changes are non-substantive corrections and clarifications to various provisions including: certain defined terms; the exclusions for temporary financing, construction and business purpose loans; financial institutions that do not meet the volume thresholds for reporting; reporting "not applicable" for certain data points such as loan purpose on cash out refis for purchased loans originated before January 1, 2018, and the loan originator's NMLSR ID for purchased loans originated before Reg. Z's loan originator rules took effect; providing a safe harbor for bona-fide errors in reporting an incorrect census tract if the institution properly uses the CFPB geocoding tool; and a number of other items. It is difficult to discuss any aspect of the 2015 HMDA rule without getting deep into the weeds, but here is an attempt to provide a brief summary of some of the more important clarifications that have been proposed.

**Defined Terms.**

- **Closed-End Mortgage Loan** – The 2015 HMDA rule defines a "closed-end mortgage loan" as a dwelling secured extension of credit that is not an open-end line of credit. The related commentary lists an installment land sales contract as an example of a transaction that would not be an extension of credit. The proposed rule would remove this example because the CFPB believes that whether or not an installment land sales contract is an extension of credit depends on the overall facts and circumstances. The commentary also explains that an extension of credit refers to the granting of credit pursuant to a new debt obligation. A transaction which modifies, renews, extends or amends the terms of an existing obligation, and is not a refinancing because it does not satisfy and replace an existing obligation with a new obligation, is generally not an extension of credit. The CFPB proposes to carve out an exception that would make all modification transactions completed under a specific New York state statute (a "New York CEMA") a new extension of credit reportable for HMDA purposes.

- **Dwelling** – The 2015 HMDA rule provides that a multi-family dwelling is a dwelling that contains 5 or more individual dwelling units and housing complexes and manufactured home communities are considered to be dwellings. Under the rule, many of the data points that must be collected on a covered loan are not required on a loan secured by a multi-family dwelling. The Bureau said it had received questions about whether a loan secured by five or more separate dwellings in more than one location would be a loan secured by a multi-family dwelling since they are not a housing complex (for example, a landlord uses a covered loan to improve 5 single family dwelling rental properties in different locations in a city) and all of which secure the loan. The Bureau believes that such a loan should be reported as secured by a multi-family dwelling and proposes to revise the commentary and include an example to make that clear.

- **Home Improvement Loan** – The CFPB proposes to amend the commentary to clarify reporting requirements for home improvement loans secured by mixed use property where a dwelling is used for both residential and business purposes. The 2015

HMDA rule excludes loans made primarily for business purposes unless made for the purpose of home purchase, home improvement or refinancing. The proposed changes to the commentary would more clearly explain that a loan to finance improvements on the commercial portion of a mixed-use multifamily dwelling (for example, an apartment building with retail space on the ground floor) is not a home improvement loan while a loan to improve or maintain the entire building or to improve the residential portion of the multi-family dwelling would be a home improvement loan. Also, a loan to improve commercial space located in a dwelling other than a multifamily dwelling (for example, a doctor's office or a daycare center located in a single family dwelling) would be a home improvement loan.

- **Home Purchase Loan** – Under the 2015 HMDA rule, a home purchase loan includes both a combined construction/permanent loan and the permanent financing that replaces a construction-only loan, but it does not include a construction-only loan that is designed to be replaced later by permanent financing. The Bureau proposes to amend the commentary to clarify that a loan is considered temporary financing and excluded from the definition of "home purchase loan" if the loan is designed to be replaced by separate permanent financing extended to the same borrower at a later time, and to clarify that a construction-only loan is also considered temporary financing and excluded from reporting if extended to a person exclusively to construct a dwelling for sale.

**Coverage and Exclusions.**

- **Temporary Financings** – Under the 2015 HMDA rule, temporary financings are excluded from coverage, and the related commentary explains that a loan is a temporary financing if it is designed to be replaced by permanent financing at a later time. The Bureau proposes to amend the commentary to specify that a loan is excluded as temporary financing if it is designed to be replaced by separate permanent financing extended to the same borrower at a later time. At the same time, the Bureau proposes to clarify that a construction-only loan extended to a person exclusively to construct a dwelling for sale (for example, a construction loan to a homebuilder) is also exempt as temporary financing. However, other short term loans are not excluded. The commentary uses as an example of a covered loan a loan with a nine month term to enable an investor to purchase a home, renovate it and resell it before the term expires.

- **Business Purpose Loans -** The 2015 HMDA rule excludes loans made primarily for business purposes unless made for the purpose of home purchase, home improvement or refinancing. The related commentary provides guidance for determining when a loan is primarily for a business purpose. The Bureau proposes to amend the commentary to this exclusion consistent with the proposed clarification of the definition of home improvement loan mentioned above so that it is clear that any loan to improve a dwelling that is not a multi-family dwelling is covered even if the loan is to improve an office or commercial space within that dwelling.

- **Covered Institutions** – Under the 2015 HMDA rule, depository institutions that do not meet a loan-volume threshold are exempt. For closed-end mortgage loans, the threshold is 25 loans originated in each of the two preceding calendar years, and for open-end lines of credit, the threshold is 100 lines of credit originated in each of the two preceding calendar years. The Bureau proposes to correct several typos where the commentary says that an institution is not exempt if it did not originate the minimum number of loans or lines of credit in each of the two preceding years by changing "each" to "either." The Bureau also proposes to clarify that institutions that do not meet the coverage test in a given year may voluntarily report data

for covered loans, but if they choose to report, they must report all covered loans just as if the institution had met the coverage test.

**Data Points and Reporting.**

- **Universal Loan Identifier (ULI)** – The 2015 HMDA rule requires financial institutions to provide a universal loan identifier (ULI) for each covered loan or application reported. The rule and related commentary also address ULI requirements for purchased covered loans and applications that are reconsidered or reinstated during the same calendar year. In addition to several other minor changes, the Bureau proposes to add a statement to the commentary providing that if a financial institution previously assigned a covered loan with a ULI or reported a covered loan with a ULI, any financial institution that purchases the loan must report the previously assigned or reported ULI. The proposal would also add language to illustrate how a financial institution should handle a situation where a covered loan was not assigned a ULI at origination, for example, when a purchased loan was originated prior to January 1, 2018.

- **Ethnicity, Race, and Sex -** The Bureau proposes to revise the instructions for reporting aggregated and disaggregated ethnic and racial data by clarifying how a financial institution reports data when an applicant selects one or more ethnicity and/or race designations/categories. The proposal is to amend Appendix B to clarify that: (i) an applicant is not required to select an aggregate category as a precondition to selecting a subcategory; (ii) if an applicant selects a subcategory but does not select the applicable aggregate category, a financial institution should not report the aggregate category; (iii) an applicant need not select "other" to provide an unlisted subcategory; (iv) a financial institution must report every subcategory selected, except where more than five subcategories are selected; and (v) a five-ethnicity maximum and related instructions apply similarly to the five-race maximum and related instructions contained in the 2015 HMDA rule.

- **Action Taken –** The CFPB proposes to clarify the reporting requirements for counteroffers as they relate to the guidance provided for conditional approvals. The proposed changes to the commentary would clarify that if an applicant agrees to proceed with an institution's counteroffer, the counteroffer would take the place of the prior application, and the financial institution would then report the action taken on the application with respect to the counteroffer rather than the original application. This would be a change from longstanding guidance regarding counteroffers.

- **Property Address –** The proposal would clarify that an institution should report “not applicable” for the property location if information about the property address, state, county, or census tract for the property securing the loan is unknown at the time the application was denied, withdrawn or closed for incompleteness.

- **Income –** The CFPB proposes to clarify that a financial institution does not include in the amount reported for gross annual income relied upon in making the credit decision any amounts derived from certain underwriting calculations that consider the potential for annuitization or depletion of the applicant’s other assets. Gross income would include amounts actually in distribution such as distributions from a retirement account. However, the proposal would not apply the exclusion to the requirement to report the monthly debt-to-income ratio relied on in making the credit decision. The reason for this is not at all clear.

- **Rate Spread and Loan Pricing Data Points (Total Loan Costs/Total Points and Fees/Origination Charges/ Discount Points/ Lender Credits/Interest Rate)** – The CFPB proposes several revisions to the commentary concerning reporting of rate spreads and loan pricing data points: (i) removal of the methodology statement for calculating the average prime offer rate (APOR) and clarifying the language of the commentary in several places relating to that change; (ii) adding statements explaining that the CFPB publishes tables of current and historic APORs by transaction type and the methodology statement for calculating the APOR on its website in addition to the FFIEC website; (iii) clarification that the APR for open-end lines of credit is calculated pursuant to Regulation Z § 1026.6 (account opening disclosures) and not § 1026.40 (early disclosures); (iv)clarification that the reporting requirements for APR and loan pricing data points for applications or preapproval requests that are approved but not accepted are based on the Reg. Z loan estimate or other early disclosures provided to the applicant; (v) clarification that where the APR or other loan pricing data points change as a result of corrected disclosures provided under Reg. Z, reporting requirements are based on the revised disclosures if the revised disclosures were provided to the borrower during the same HMDA reporting period in which the loan closed; and (vi) guidance stating that the rate set date for applications received through a broker is the date the lender sets the rate with the broker and not the date the broker sets the rate with the borrower.

- **Credit Score** – Except for purchased loans, the 2015 HMDA rule requires an institution to report the credit score or scores relied upon in making the credit decision and the name and version of the scoring model used to generate each score. The proposal would amend the commentary to clarify how to report composite scores and a single score when there are multiple applicants. The Bureau proposes to clarify that where a composite score is used, the institution should report the composite score and report that more than one scoring model was used. In a transaction with two or more applicants where the institution obtains or creates and relies on a single credit score, the institution may report that score for the applicant, and may report "not applicable" for the co-applicant, or, vice-versa.

- **Combined Loan-To-Value Ratio (CLTV)** – The Bureau proposes to add a comment explaining that where multiple properties are involved, the institution reports the combined LTV ratio relied upon, regardless of which property or properties is included in the calculation.

- **Introductory Rate Period** – The proposal would add a new comment explaining that where a covered loan or application includes an introductory rate that is calculated in a manner other than months, the introductory rate period is reported using the equivalent number of whole months without regard for any remainder in the calculation. An institution would report one month for any introductory rate period of less than one month.

We will continue to monitor the CFPB for further developments. For HMDA reporters and about-to-become-reporters, watch for news from us later this summer on HMDA training.

(Cliff Harrison)

## HMDA DATA COLLECTION WILL IMPACT FAIR LENDING

Much time has been devoted to covering the recent changes to Regulation C which implements the Home Mortgage Disclosure Act (HMDA).

The focus for most of this time has been on the mechanics of revised Regulation C: the new coverage rules, the collection of applicant or borrower demographic information, and most importantly, the expanded set of data points that must be collected and reported for each application and loan originated.

But the new HMDA data collection and reporting requirements are much more significant than just getting the HMDA LAR right. The information this expanded data reporting format will entail will have significant implications for your loan policies and procedures and for the manner in which you price your loans. The expanded Regulation C data reporting requirements will have significant implications for Fair Lending compliance and for your Bank's lending "best practices."

For a number of years now we have stressed the need to know what your loan data says about your loan origination and loan pricing policies and practices. With the expansion of the Regulation C data collection process, much more information will be available, not just to your regulator(s) but also to the public and to consumer advocacy groups.

Of course, "disparate impact" (a policy that has a discriminatory effect and that does not have an off-setting business necessity, regardless of intent) is a primary concern here. Do your policies and/or practices accommodate one set of borrowers while disadvantaging others?

In the past, the old HMDA data served as the starting point for many Fair Lending exams conducted by the regulators. But that old data set was limited in scope and often required extensive supplementation during a Fair Lending examination to determine whether or not a bank discriminated. This "file review" process was time consuming and expensive.

With the new and expanded data reporting format every HMDA reporting bank will be much more "transparent" or visible to the regulators, the public, etc. That can be either good for your Bank or bad. It will be good if the sum total of data reported shows a consistent, nondiscriminatory application of a well-planned and implemented loan origination and loan pricing regime. It will be bad if the data, instead, shows a pattern or practice of treating certain applicants differently for no necessary reason.

**The New Data Points**. A number of new items of information will have to be reported. Among these are:

- property address;
- applicants' or borrowers' age;
- credit scores;
- total loan costs or total points and fees;
- total origination charges;
- points paid to reduce the interest rate;
- amount of lender credits;
- interest rate on approved loans;
- term in months of any prepayment penalty;
- debt-to-income ratio;
- number of months to maturity;
- number of months until first interest rate change;
- balloon payment, interest-only, negative amortization, etc.;
- value of property;
- whether secured by manufactured housing;
- ownership or lease of land for manufactured housing;
- loan origination channel;
- name of automated underwriting system used and results generated;
- etc.

Some of these fields will reveal information about your loan underwriting practices, e.g., age, credit score, debt-to-income ratio, property

value, loan origination channel, manufactured housing, etc.

Other fields will tell about your loan pricing practices; e.g., total costs, total fees and charges, total origination charges, total points, interest rate, etc.

The sum total of this data will paint a picture of each loan and of your entire loan portfolio. If that picture is clear and in focus, it hopefully will reveal a bank with sound underwriting practices that are consistently applied, with a well thought out list of exceptions that would allow loans to be generated in a way that is neutral with respect to protected classes of individuals.

Likewise, your expanded data set should show a regime for loan pricing that is consistent and risk-based and free from discretionary influence.

The expanded data set takes aim at creating transparency in these two areas. You need to plan in advance to be sure that this transparency works for you and not against you.

I am reminded that under the old HMDA data reporting process we were often able to convince the regulators that what seemed to be a discriminatory data set was actually not discriminatory at all by adding in unreported data such as credit score. Now, however, much of that data will already have been factored into a regulator's findings, making it much more difficult to disprove a charge of discrimination. Better to know that your data is clear, clean and transparent before the examiners do their review.

Much has been said about the role that your loan officers and support staff will play in complying with the revised Regulation C. After all, they will be the focal point for the expanded data collection. The data they submit will tell the story about your loan portfolio and your Bank's Fair Lending Program. A great deal of thought and planning needs to go into the loan underwriting and loan pricing policies that govern the loan officers' decision making process. Unmanaged discretion on the part of loan officers will very likely lead to inconsistent loan underwriting and loan pricing that will be both apparent to your regulator and very hard to explain away.

**The Goal: Consistency**. You will need to implement systems and processes to ensure lending consistency. More so than ever, you will need to have well developed underwriting criteria and a limited set of exceptions that are well defined and may allow some variance within your underwriting criteria.

The same is true for your loan pricing.

You will need to monitor your loan underwriting, both for loan approvals and declines and every loan file should be documented to show either how the application and approval process complied with your underwriting policies, or how an approved loan adhered to an approved exception process.

The same is true for your loan pricing.

You should be prepared to defend each loan file individually. Regulators will look for "false positives" in your expanded HMDA data set. You need to be able to defend the underwriting or pricing of those particular loans based on policy consistently applied and documentation contained in the file.

In conclusion, expanded Regulation C data reporting requirements will be upon us before we know it. It won't be enough to simply know the mechanics of what information to report. Every bank needs to delve more deeply into the policies and procedures, especially for loan underwriting and loan pricing, that will generate the data that then gets reported.

Transparency for your loan portfolio based on this expanded HMDA data can either benefit your Bank, or hurt it badly. It is more important

now than ever that you manage your loan processes and know what your data says.

(Ed Wilmesherr)

## CREDIT CARD COMPLIANCE WITH THE MLA

Last year we spent a lot of time preparing for the implementation of the Department of Defense's final rules expanding the scope of the Military Lending Act that became effective on October 3, 2106 (the "Final Rule"). The Final Rule imposed an interest rate limit on extensions of consumer credit made to covered borrowers, restricted certain terms and required specific disclosures for consumer credit extended to covered borrowers. Consumer credit is defined, for these purposes, as any extension of credit for personal, family or household purposes subject to a finance charge or payable by written agreement in more than four installments except residential mortgages, purchase money automobile and personal property transactions secured by the auto or other property being purchased, loans in amounts above the Regulation Z coverage threshold, and business purpose loans. A covered borrower is any member of the armed forces on active duty or on active Guard and Reserve duty, and his or her dependents.

The definition of consumer credit includes open-end, not home secured credit card accounts, which were previously exempt from coverage under the MLA. We haven't spent a lot of time discussing the rules related to credit card accounts because those rules were given an extension for compliance until October 3, 2017. That date is quickly approaching, so we want to remind you of this upcoming date and highlight the rules related to credit card accounts so that you may begin working towards compliance.

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 are otherwise excluded from the finance charge and APR under Reg Z. The Final Rule provides guidance on calculating the MAPR for both closed-end and open-end credit.

The MAPR for open-end credit is calculated in the same way as the effective APR for a billing cycle under Regulation Z and includes all of the fees included for closed-end credit. A fee may not be charged in a billing cycle where there is no balance except for a participation fee equal to or less than $100 per year. Fees that are not included in the MAPR calculation, such as a late fee, may be charged even during a billing cycle with no balance. Certain bona fide and reasonable credit card fees, other than the periodic rate, such as application fees, participation fees, or transaction-based fees may be excluded from the MAPR. Reasonableness is determined by comparing the fee imposed with fees typically charged by other creditors for a similar product.

The Final Rule provides a safe harbor for the reasonable determination. If a fee 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 prior to the time the average is computed, then the fee is reasonable. Creditors may rely on sources of information compiled in commercially available databases or other industry services when making the reasonableness determination.

A bona fide fee may not be unreasonable solely because it is higher than the determined average amount; other factors related to the credit card account should be considered. A credit card participation fee may be considered reasonable if the amount reasonably corresponds with factors such as the card's credit limit and services or benefits offered to the borrower through the account. Additionally, a bona fide fee is not automatically considered to be

unreasonable solely because other creditors do not charge a fee for the same or similar product or service.

The exclusion of bona fide fees from the MAPR calculation on an open-end, not home secured credit card, does not apply to credit insurance premiums, debt cancellation or debt suspension fees, or any ancillary product fees. If a creditor charges any fee in addition to a finance charge included in the MAPR that does not meet the requirements for bona fide or reasonable, then the total amount of all fees must be included in the MAPR even if some of the fees might have otherwise been excluded.

(Memrie Fortenberry)

## CFPB DELAYS PREPAID ACCOUNTS RULE

On April 25, the Consumer Financial Protection Bureau announced that it was delaying the effective date of the Prepaid Accounts Rule for six months to April 1, 2018. In its proposal issued earlier in the month, the Bureau explained that it was listening to industry participants who said more time is needed to allow for package printing and pulling and replacement of prepaid cards sold at retail outlets in order to accommodate the new disclosure requirements. The Bureau also said that it would use the additional time to revisit two substantive issues and that it may issue additional changes later through a separate notice and comment rulemaking process. Those additional issues relate to the linking of credit cards to digital wallets that are capable of storing funds and to error resolution procedures for prepaid accounts prior to account registration. The Bureau also indicated that it was continuing to evaluate other concerns about the rule raised by industry participants.

We covered the Prepaid Accounts Rule in detail in the November 2016 Quarterly Report and the February 2017 quarterly meeting. The rule amends Regulation E to add prepaid accounts as a new type of covered account and to add new and extensive consumer protections for those accounts including long and short form disclosures, limitations on consumer liability for unauthorized transactions, mandatory error resolution procedures, periodic account statements (with some exceptions), and posting of account agreements online and submission of those agreements to the CFPB. The rule also amended Regulations E and Z to regulate overdraft credit features linked to prepaid accounts.

Legislative bills have been introduced in the both the U.S. House and Senate that would overturn the rule entirely using the Congressional Review Act, but those bills face a quickly approaching May 9 deadline for passage. Some say the Bureau's action in pushing out the effective date and holding out the possibility of further changes to address industry concerns is an attempt to thwart the efforts of some Republicans in Congress to roll back the rule before it takes effect. Time will tell, but the delayed effective date is still good news for sellers of prepaid products.

(Cliff Harrison)

## RECONCILING REGULATIONS B AND C RACE AND ETHNICITY REQUIREMENTS

As everyone knows, Regulation B, which construes the Equal Credit Opportunity Act (“ECOA”) prohibits a creditor from inquiring about the race, color, religion, national origin or sex of a loan applicant in connection with a credit application. At the same time, Regulation B provides an exception to that prohibition, including information about

ethnicity and race, for monitoring purposes in connection with certain dwelling-secured loans.

In a somewhat similar fashion, lenders covered by Regulation C are required to collect, record and report certain information regarding ethnicity and race that would be otherwise prohibited by Regulation B.

The revised Regulation C will require banks to permit applicants to self-identify using "disaggregated" ethnic and racial categories beginning January 1, 2018. Until then such inquiries would not be required by Regulation C, or allowed by Regulation B. Therefore, creditors would be prohibited by Regulation B from requesting applicants to self-identify using the disaggregated ethnic and racial categories.

However, ECOA contains a provision which provides that no liability shall apply to any act which is in good faith conformity with any official rule or interpretation of the CFPB. The CFPB issued such a rule on September 23, 2016, effective January 1, 2017. This rule roughly coincides with action by the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA) to issue a revised Uniform Residential Loan Application on August 23, 2016, which allows for applicant self-identification using disaggregated ethnic and racial categories. Many lenders use these forms.

In an effort to address any areas of conflict or inconsistency, the CFPB has issued its official approval which states that at any time from January 1, 2017 through December 31, 2017, a creditor may, at its option, permit applicants to self-identify using the disaggregated ethnic and racial categories contained in the FHLMC and FNMA loan application forms. In this way, lenders so choosing will be deemed to be in compliance with the applicable requirements of both Regulations B and C.

The CFPB is of the opinion that the early collection of disaggregated ethnic and racial categories could help institutions in their preparations for complying with revised Regulation C come January 1, 2018. Doing so prior to that date would not prejudice applicants and could simplify Regulation C compliance preparations.

For such data collected between January 1, 2017 and December 31, 2017, banks would still report ethnicity and race using only aggregate categories -- a little confusing, but necessary for the integrity of the data reported.

All of this is a little cumbersome, but it does represent the CFPB trying to be helpful.

(Ed Wilmesherr)

## MSRCG MEETING TO BE HELD ON MAY 23, 2017

The MSRCG will hold its May Meeting on May 23, 2017, 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.

We have a busy agenda for the May Meeting. We will begin with a refresher on Regulation O compliance, including a review of common Reg. O problems and violations, followed by a discussion of ways to deal with conflicts of interest. Then we will have a presentation on the Military Lending Act followed by a discussion of the Fair Lending implications for the new HMDA data collection requirements. Finally, Patsy Parkin will lead a general discussion of the mechanics (loan coverage and classification, expanded data collection, etc.) of complying with revised Regulation C.

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 18, 2017, so that arrangements for lunch can be finalized. We look forward to seeing you there.

(Ed Wilmesherr)

## MRCG MEETING TO BE HELD ON MAY 25, 2017

The MRCG will hold its May Meeting on May 25, 2017, at the Mississippi Sports Hall of Fame & Museum Conference Center, 1152 Lakeland Drive, Jackson, Mississippi. Registration for will begin at 9:00 a.m. with the meeting to begin at 9:30 a.m..

We have a busy agenda for the May Meeting. We will begin with a refresher on Regulation O compliance, including a review of common Reg. O problems and violations, followed by a discussion of ways to deal with conflicts of interest. Then we will have a presentation on the Military Lending Act followed by a discussion of the Fair Lending implications for the new HMDA data collection requirements. Finally, Patsy Parkin will lead a general discussion of the mechanics (loan coverage and classification, expanded data collection, etc.) of complying with revised Regulation C.

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 19, 2017, so that arrangements for lunch can be finalized. We look forward to seeing you there.

(Ed Wilmesherr)

MRCG-MSRCG COMPLIANCE CALENDAR

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| 01/01/2017 – HMDA exception for low volume depository institutions effective | 08/22/2017 - MSRCG Quarterly Meeting |
| 01/06/2017 – Comments due on interagency proposed rule on private flood insurance | 09/21/2017 - MRCG-MSRCG Joint Steering Committee Meeting |
| 01/19/2017 – MRCG-MSRCG Joint Steering Committee Meeting | 10/03/2017 – MLA coverage expands to include credit cards |
| 02/16/2017 – MRCG Quarterly Meeting | 10/19/2017 – Reg. Z and Reg. X Mortgage Servicing Amendments effective |
| 02/28/2017 – MSRCG Quarterly Meeting | 11/14/2017 - MSRCG Annual Meeting |
| 04/20/2017 - MRCG-MSRCG Joint Steering Committee Meeting | 11/16/2017 - MRCG Annual Meeting |
| 05/04/2017 – Comments due on CFPB proposed changes to Reg. B on collection of monitoring information on home loan applications | 01/01/2018 – Revised HMDA data collection begins |
| 05/23/2017 - MSRCG Quarterly Meeting | 04/01/2018 – Reg. E and Reg. Z Prepaid Accounts rule effective |
| 05/25/2017 - MRCG Quarterly Meeting | 04/19/2018 – Reg. Z and Reg. X Mortgage Servicing Amendments to bankruptcy periodic statements and successors in interest effective |
| 05/25/2017 – Comments due on CFPB proposed amendments to 2015 HMDA rule | 05/11/2018 – FinCEN BSA enhanced customer due diligence rules effective |
| 07/20/2017 - MRCG-MSRCG Joint Steering Committee Meeting | 01/01/2019 – Revised HMDA data reporting begins |
| 08/17/2017 - MRCG Quarterly Meeting | |