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Quarterly Report

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REGULATION CC FINAL RULE TO BECOME EFFECTIVE

At long last, the Federal Reserve Board issued a final rule amending Regulation CC – Expedited Funds Availability and Collection of Checks. Issued in June of 2017, the rule becomes effective July 1, 2018. As everyone knows, Reg. CC implements the Expedited Funds Availability Act of 1987 (EFA Act) and the Check Clearing for the 21st Century Act of 2003 (Check 21 Act) which dealt with prompt funds availability for deposited items and collection and return of paper checks and substitute checks. In this latest rule, the Board modified subparts A, B and C of the regulation to recognize today's environment in which almost all check collection and returns are handled electronically and to encourage all banks to receive, send, and return the few remaining paper checks electronically. In brief, the Board retained the current same-day settlement rule for paper checks, applied Reg. CC's existing check warranties under subpart C to checks that are collected electronically, and adopted new warranties and indemnities related to checks collected and returned electronically and to electronically-created checks. The changes will be particularly helpful in sorting out who is responsible for double presentment when a check is deposited via remote deposit capture (RDC) and (somehow by hook or crook) the original check is also deposited somewhere. In this article, we will provide a little background and then summarize the major changes contained in the new rule.

Background. As a refresher, Reg. CC is divided into subparts. Subpart A contains general information including definitions of terms. Subpart B specifies the times within which banks must make funds available for withdrawal and exceptions to those availability schedules, bank disclosure requirements for their funds availability policies, and payment of interest. Under the Dodd Frank Act, the Fed shares jurisdiction with the CFPB for writing subpart B. Subpart C implements the EFA Act's provisions regarding forward collection and return of checks.

The current provisions of subpart C presume that banks generally handle checks in paper form and include provisions to speed the collection and return of checks, such as the expeditious return requirements for paying and returning banks, authorization to send

Regulation CC Final Rule
To Become Effective 1
Redlining Analysis and REMAs 4
Revisiting the SAFE Act 6
CFPB 2018 7
MRCG Meeting – February 15, 2018........ 8
MSRCG Meeting – February 27, 2018 9
MRCG-MSRCG Compliance Calendar .. 10

returns directly to depositary banks, notification of nonpayment of large-dollar returned checks, standards for check indorsement, and specifications for same-day settlement of checks presented to the paying bank.

The Check 21 Act, which became effective in October 2004, facilitated electronic collection and return of checks by permitting banks to create a paper "substitute check" from an electronic image and electronic information derived from a paper check. The Check 21 Act authorized banks to provide substitute checks to a bank or a customer that had not agreed to electronic exchange.

Return Requirements. Regulation CC requires a paying bank that determines not to pay a check to return the check expeditiously. Under the current rule, a paying bank must return the check under either the "two-day test" or the "forward-collection test." A paying bank may send a returned check either directly to the depositary bank or to any bank agreeing to handle the return expeditiously. The current rule also requires a paying bank that decides not to pay a check of $2,500 or more to provide a notice of nonpayment to the depositary bank in a manner so that the notice is received by the depositary bank within the same "two-day test" timeframe for expeditious return.

Of course, the original rule was written at a time when check processing was almost entirely paper-based. Today, check clearing is almost entirely electronic. The Fed says that by the beginning of 2017, more than 99.99 percent of checks received by Fed. Reserve Banks were received electronically from 99.06 percent of routing numbers and over 99.99 percent of checks were presented to paying banks electronically to over 99.76 percent of routing numbers. A small portion of check returns, however, are still conducted using paper. By the beginning of 2017, Fed. Reserve Banks received 99.63 percent of returned checks electronically from over 99.37 percent of routing numbers and delivered 99.41 percent of returned checks electronically but to only 92.84 percent of routing numbers. I guess there are still a few holdouts.

In the final rule, the Board required all returned checks, both paper and electronic, to satisfy a modified version of the "two-day test." They must be returned in an expeditious manner so that the check would normally be received by the depositary bank not later than 2 p.m. (local time of the depositary bank) on the second business day following the banking day on which the check was presented to the paying bank. The Board also added a new condition for expeditious-return liability, saying that a paying bank and returning bank may be liable to a depositary bank for failing to return a check in an expeditious manner only if the depositary bank has commercially reasonable means in place for receiving check returns electronically, either directly or indirectly through an intermediary or correspondent. The Board believes this will provide incentives to depositary banks to receive electronic returns by preserving their ability to make a claim that a check was not returned expeditiously only if they actually receive electronic returns. The final rule also provides that if a paying bank decides not to pay a check of $5,000 or more (up from the current $2,500 threshold), it must provide a notice of nonpayment in a manner so that the notice would be received by the depositary bank by 2 p.m. (rather than the current deadline of 4 p.m.) on the second business day following the banking day on which the check was presented to the paying bank.

Same-Day Settlement. Currently, Reg. CC requires a paying bank to provide same-day settlement for checks presented in accordance with reasonable delivery requirements established by the paying bank and presented at a location designated by the paying bank by 8 a.m. (local time of the paying bank) on a business day. A paying bank may not charge presentment fees for checks—for example, by settling for less than the full amount of the checks—that are presented in accordance with same-day settlement requirements. In its final rule, the Board retained the current same-day settlement rule, with only minor technical changes.

Electronic Check Collection and Returns. Currently, Subpart C applies only to paper checks, so the provisions regarding acceptance of returned checks, presentment, and warranties do not apply to electronic images of checks (“images”) or to electronic information derived from checks (“electronic information”). Presently, the collection and return of images and electronic information are governed by agreements between the banks which may be in the form of the Federal Reserve Banks' operating circular, for items cleared through the Fed, or a clearinghouse agreement, like the ECHHO rules. The agreements often include, among other terms, warranties for electronic checks similar to those made for substitute checks under the Check 21 Act (“Check-21-like warranties”).

In the final rule, the Board amended subpart C to create a regulatory framework for the collection and return of electronic images and electronic information. The Board defined the terms “electronic check” and “electronic returned check” as an electronic image and electronic information derived from a check or returned check. The Board also applied the provisions of subpart C to banks that send and receive these items by agreement as if they were checks, unless otherwise agreed by the sending and receiving banks. So, subpart C will generally apply to all electronic checks, but clearinghouse rules may still override it.

The Board also applied existing paper-check warranties and the Check-21-like warranties to electronic checks and electronic returned checks. The existing paper-check warranties include the returned-check warranties; the notice of nonpayment warranties; the settlement amount, encoding, and offset warranties; and the transfer and presentment warranties related to a remotely-created check. The Check-21-like warranties include warranties that a bank will not be asked to pay an item twice and that the electronic image and electronic information are sufficient to create a substitute check. These warranties ensure that a bank that receives a check for collection, presentment, or return receives the same warranties regardless of whether the check is in paper or electronic form.

The Board also added new indemnities for electronically-created items, which are check-like items created in electronic form that never existed in paper form. Electronically created items can be difficult to distinguish from electronic images of paper checks. The final rule defines “electronically-created item” to mean an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not from a paper check. Under the final rule, a bank transferring an electronically-created item indemnifies each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against any loss, claim, or damage that results from the fact that the image or information was not derived from a paper check. The rule also limits the amount of the indemnity to the amount of the

indemnified bank's loss, not to exceed the amount of settlement or other consideration received by the indemnifying bank plus interest and expenses of the indemnified bank (including costs and reasonable attorney's fees and other expenses of representation). The Board also adopted new indemnities for losses due to the fact that: (1) the electronically-created item was not actually authorized by the account holder, or (2) a subsequent bank pays an item that has already been paid. The Board believes that these indemnities will provide basic protections for banks handling electronically-created items that are unauthorized or presented more than once.

Finally, the Board added a new indemnity for remote deposit capture that would indemnify a depositary bank that takes an original paper check for deposit which is then returned unpaid because the check was previously deposited using a remote deposit capture service and the image was paid by the paying bank. The Board believes this places the risk on the bank that is in the best position to prevent multiple deposits of the same item, namely, the bank taking the imaged deposit via RDC. The indemnity is limited to the consideration received by the indemnifying bank plus interest and attorneys fees and expenses. The Board added an exception to this indemnity that will prevent an indemnified bank (the bank taking the original paper check for deposit) from making an indemnity claim if the paper check it accepted contained a restrictive indorsement that is inconsistent with deposit of the physical check, such as an indorsement "for mobile deposit only." Banks utilizing remote deposit capture will want to be sure they have appropriate provisions in their customer agreements and procedures in place for making sure that before sending the image to the bank, the RDC customer indorsed the original check in a way that will help prevent later deposit of the original paper check.

We will discuss these changes and more at the quarterly meeting.

<Cliff Harrison>

REDLINING ANALYSIS AND REMAs

The old adage goes: nature abhors a vacuum. The meaning is clear. If something (or some agency) steps away or is removed, something else will quickly take its place. This will almost surely be the case as CFPB steps back and reexamines itself, and possibly decreases (perhaps only temporarily) its emphasis on Fair Lending enforcement action. The various bank regulatory agencies will very likely fill any void by exercising their own power to examine and enforce Fair Lending Laws or regulations. It is only natural that the bank regulatory agencies would assume this role, given the years they have spent subordinate to the CFPB, and actually under an MOU themselves relative to Fair Lending examinations.

The different regulators, the FDIC in particular, have been aggressive in conducting Fair Lending examinations, using both old and new criteria to look for Fair Lending risks. Let's take a look at one of the risks that the regulators are currently examining for.

Redlining is considered a major risk. Redlining is defined as:

> "illegal disparate treatment in which a lender limits access to credit, or provides less favorable terms, because of the prohibited basis characteristics of a particular area."

The FDIC in particular has identified some 12 risk factors for Redlining discrimination, such as:

- Significant differences in HMDA data with respect to applications received, withdrawn, approved but not excepted, and closed for incompleteness for high minority areas verses low minority tracts;
- Significant differences in approval/denial rates in high verses low minority tracts; and
- Significant differentiation between denials for insufficient collateral in high minority tracts verses low minority tracks.

You would do well to review all 12 risk factors as a refresher on Redlining and Fair Lending.

Over the course of the past year, the FDIC has taken a slightly altered approach to conducting a Redlining review. In addition to examining a bank's CRA Assessment Area, the regulators additionally now ask to look at the bank's "Reasonably Expected Market Area" or "REMA".

Everyone understands that the CRA Assessment Area is that area within which the bank should be meeting the reasonably expected credit needs of the community. But what is a bank’s Reasonably Expected Market Area, or REMA, and how does it factor into a Redlining analysis?

The FFIEC Fair Lending Procedures define a REMA as:

> "where the bank actually marketed and provided credit, and where it could reasonably be expected to have marketed and provided credit." (Emphasis supplied.)

You can readily see that the REMA could be both different from, and larger than, the bank's CRA Assessment Area.

The REMA analysis asks whether the bank is providing equal access to credit in its REMA, and includes examining whether the bank is:

- Not extending credit in certain areas;
- Targeting certain areas with less advantageous products;
- Offering different loans to different areas; or
- Not marketing residential loans in certain areas.

An unfavorable finding in any of these areas could trigger an accusation of Redlining.

So, how do the regulators determine your REMA? First, they began with a discussion with the bank's management. Then they look at the bank's pattern of branch and office location. A more detailed inquiry will then look to the bank's marketing efforts including:

- Print advertising;
- Calling program; and
- Direct mailings.

That inquiry will be followed by an inquiry into the bank's use of real estate loan brokers or realtors, focusing on the location and areas those realtor/brokers actively serve. And last, but not least, the regulators will ask to see a map or plot of the bank's loan applications and originations. If a need is indicated, examiners may also look at the bank's

complaints log and possible supplemental information such as credit demand and the impact of competition from other lenders.

Well then, what steps should you take to get ready for your REMA/Redlining examination? Here are some suggestions from the regulators:

- Conduct your own REMA Redlining risk assessment (i.e., identify your REMA);
- Review your policies and procedures for Redlining risk;
- Conduct a comprehensive data analysis, including a geocoding of loans;
- Review all marketing efforts;
- Conduct a branch/LPO analysis;
- Compare your bank to other peer banks; and
- Document your findings and your business reasons for your marketing and other efforts within your REMA.

The regulators keep searching for ways to improve their Fair Lending examination process and ferret out any possible discrimination. The use of a REMA analysis is just the most recent step in that process. We will have an in-depth discussion of Fair Lending in general, and REMAs in particular, at the February Quarterly Meeting.

<Ed Wilmesherr>

REVISITING THE SAFE ACT

It's been a while since we have talked about the SAFE Act, but I think it's time! This requirement is one that sometimes we don't think about, but there are definite rules that must be followed. So we are going to walk through definitions, requirements, and issues we see.

As a reminder, the SAFE Act ("Secure and Fair Enforcement") applies to mortgage licensing. It is important to first know who is required to be registered – thus one issue we sometimes see. A mortgage loan originator is an employee who takes a residential mortgage loan and offers <u>or negotiates</u> terms of a residential mortgage loan. It does not include someone who performs purely administrative or clerical tasks in support of a Mortgage Loan Originator. So many times we see a secretary <u>negotiating</u> terms of a residential mortgage loan and they are not registered!! We will get into more detail and some examples at the meeting.

There are specific registration requirements, too. This includes general information, AND information on financial systems employment history for 10 years prior to the date of registration or renewal, convictions of any criminal offense, civil actions against the employee, fingerprints, and a few others.

In addition, banks must have a written MLO Policy, an administrator to ensure that all of the requirements are met, registration renewals, etc. There are even procedures if an MLO's name changes, a new employee previously registered becomes employed by your bank, if criminal activity is discovered,

and if an employee leaves. Whew! A "little" regulation with potentially a lot of punch. But hopefully by the time we finish, you will all be "experts."

<Patsy Parkin>

CFPB – 2018

Late in 2017, Richard Cordray's departure from the Consumer Financial Protection Bureau (the "CFPB") set in motion a chain of events that will have a lasting impact on the function of that agency.

Everyone knows that the CFPB was created in 2010 by the Obama Administration as part of the Dodd-Frank Act. The sole purpose of the CFPB was, and is, to protect consumers from the abuses that led to the financial crisis of 2008 – 2009. To do that, the CFPB was given responsibility for enforcing virtually all of the federal consumer protection laws that had been passed over the previous 30+ years. That shift in responsibility and power came at the expense of the Federal Reserve Board and the other bank regulatory agencies that had been criticized for not using their enforcement and examination powers to adequately protect consumers.

Cordray's departure set up a power struggle between the Trump Administration and the administration of the CFPB. It appears fairly settled now that Trump's appointee, Mick Mulvaney, will be the interim director. He has already begun to take steps to effect change at the CFPB. But how much change can really take place? And will that change be for the better?

Focus on the facts. Mulvaney is a part-time director. His real job is Director for the White House Office of Management and Budget. Still, he is having an initial impact by bringing in some higher level staff to help with the administration of the CFPB. Among these hires are employees from his budget office and two former staffers to the Financial Services Committee of the House of Representatives. It is not clear how much knowledge or experience these individuals bring to the job, but it is likely that they will pursue a course of regulatory reduction which can be followed up on when a full-time director is appointed.

Mulvaney has taken some early steps that appear aimed at reining in the CFPB. He has asked that a series of public comment and review hearings take place that will cover matters such as enforcement, supervision, rulemaking, market monitoring and education activities of the agency. The first request will focus on Civil Investigative Demands or "CIDs". Since a CID is an early step in most enforcement actions, this inquiry may signal some limits on the overall use of enforcement actions. He has also reopened the Payday Lending Rule, giving that industry at least some temporary relief.

Right now there are many more questions than there are answers. It is entirely possible for the Trump Administration to create an environment of negativity at the agency that has the legislatively decreed responsibility for writing and enforcing consumer protection regulations, but is that a good thing? Lax enforcement of consumer protection laws led to the creation of CFPB in the first place, and placed bank regulators in a subservient roll. Do we want to repeat that process?

The Trump Administration will come to an end later, if not sooner. If the pendulum of consumer protection regulation (or the lack of such protection) swings too far to the right, it

almost surely invites a similar swing in the opposite direction in years to come. Banks and compliance officers do not need to be whipsawed in that manner, with just enough time to adjust to one set of expectations, only to see priorities change and a new set of demands be imposed.

Banks have devoted a lot of time and money getting ready for the regulatory requirements proposed by the CFPB under Richard Cordray. Change, even "favorable" change, will cost more in time and money. And then all of that could be reversed by a new administration. Perhaps we should all just hope for a calm, measured approach that really does continue to protect consumers in a concerted way, while searching for reasonable and efficient practices that will hold down on the price of compliance and increase the availability of credit.

Remember that federal consumer protection regulation is very different from many other forms of government regulation. The Equal Credit Opportunity Act and the Truth in Lending Act (as only two examples) are very detailed legislative enactments. The details of these laws are fleshed out by regulations B and C which the CFPB has authority over. In other words, the laws tell you "what" to do, and the CFPB regulations tell you "how" to do it. We all need that clarification and the legal protection that comes with following the regulations. To effect significant change will take legislative action, and with the current dysfunction in Congress and the White House, as well as more pressing legislative matters, it is highly unlikely any of the federal consumer protection laws will be modified. Ultimately the CFPB may find itself with its hands somewhat tied, and after all acting Director Mulvaney has said that he does not want to "blow up" the CFPB.

We will simply have to wait and see what develops.

<Ed Wilmesherr>

MRCG QUARTERLY MEETING TO BE HELD ON FEBRUARY 15, 2018

The MRCG will hold its February Quarterly Meeting on February 15, 2018, 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..

The February meeting will feature a presentation on the Final Rule amending Reg. CC (Expedited Funds Availability Act), which becomes effective July 1, 2018. We will also have a presentation on Fair Lending issues, especially the regulators' use of your bank's "Reasonably Expected Marketing Area" ("REMA") as a part of a redlining analysis. Other presentations will focus on SAFE Act compliance and a number of miscellaneous compliance topics.

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, February 9, 2018, so that arrangements for lunch can be finalized. We look forward to seeing you there.

<Ed Wilmesherr>

MSRCG QUARTERLY MEETING TO BE HELD ON FEBRUARY 27, 2018

The MSRCG will hold its February Quarterly Meeting on February 27, 2018, 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.

The February meeting will feature a presentation on the Final Rule amending Reg. CC (Expedited Funds Availability Act), which becomes effective July 1, 2018. We will also have a presentation on Fair Lending issues, especially the regulators' use of your bank's "Reasonably Expected Marketing Area" ("REMA") as a part of a redlining analysis. Other presentations will focus on SAFE Act compliance and a number of miscellaneous compliance topics.

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, February 22, 2018, so that arrangements for lunch can be finalized. We look forward to seeing you there.

<Ed Wilmesherr>

MRCG-MSRCG COMPLIANCE CALENDAR

01/01/2018 – Amendments to Reg. B on collection of ethnicity and race information effective	07/01/2018 – FRB amendments to Reg. CC effective
01/01/2018 – Revised HMDA data collection begins	07/19/2018 - MRCG-MSRCG Joint Steering Committee Meeting
01/18/2018 - MRCG-MSRCG Joint Steering Committee Meeting	08/16/2018 - MRCG Quarterly Meeting
02/15/2018 – MRCG Quarterly Meeting	08/21/2018 - MSRCG Quarterly Meeting
02/27/2018 - MSRCG Quarterly Meeting	09/20/2018 - MRCG-MSRCG Joint Steering Committee Meeting
03/19/2018 – Mandatory compliance date for CFPB arbitration rule	10/01/2018 – Reg. Z TRID clarifications and technical amendments mandatory compliance date
04/19/2018 - MRCG-MSRCG Joint Steering Committee Meeting	11/13/2018 - MSRCG Quarterly Meeting
04/19/2018 – Reg. Z and Reg. X Mortgage Servicing Amendments to bankruptcy periodic statements and successors in interest effective	11/15/2018 - MRCG Quarterly Meeting
05/11/2018 – FinCEN BSA enhanced customer due diligence rules effective	01/01/2019 – Revised HMDA data reporting begins
05/17/2018 - MRCG Quarterly Meeting	04/01/2019 – Reg. E and Reg. Z Prepaid Accounts rule effective
05/22/2018 - MSRCG Quarterly Meeting	08/19/2019 – Mandatory compliance date for CFPB Rule on Payday, Vehicle Title and High Cost Installment Loans