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Quarterly Report

Mississippi Regulatory Compliance Group

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LINKED ACCOUNTS AND OVERDRAFT CONCERNS

Many banks offer customers the option of linking a checking account to another type of account such as a savings account, money market deposit account, or line of credit as a means of providing overdraft protection. The idea is that when the customer has insufficient funds in the checking account, funds from the linked account are automatically transferred to the checking account so that the customer does not have an overdraft or NSF item and incur the associated OD fee. If a fee is charged for a transfer between linked accounts, it is typically lower than a NSF or OD fee.

The agencies have, indirectly at least, encouraged the offering of these services as a lower cost alternative to overdraft protection programs and related overdraft fees. However, an article in the most recent Dallas Region Quarterly Newsletter highlighted potential compliance issues related to these linked accounts offered as overdraft protection.

Banks have been cited for both Regulation DD violations as well as for unfair or deceptive acts or practices in connection with these services. Research to identify all affected consumers and restitution for fees charged have been required for violations. If your bank offers linked accounts as a means of overdraft protection, then it is important to review the bank's practices regarding the program and compare those practices with related disclosures, agreements and marketing materials. It is very important that what is disclosed to the customer in these documents accurately and adequately reflects the bank's actual practices and how your system is set to treat the transfers and linked accounts.

Typically, a bank's marketing materials, account agreements, documentation, and disclosures describe the benefits of a linked account as a means of avoiding overdraft fees. Documentation may say that transfers will be made to cover the overdraft. Some have stated or implied that transfers will occur only when the linked account contains sufficient funds. Examiners have discovered instances in which transfers may be made when both the checking account and the linked account have insufficient funds. This can create a situation in which a customer will incur a transfer fee, possibly interest on a line or credit, and still incur an OD or NSF fee on the checking account, all while the customer

- Linked Accounts and Overdraft Concerns 1
- Proposed Small Business Loan Data Collection Rule 2
- A Little Bit of This and That 5
- Get Ready for 1071 6
- Proposed Guidance on Third-Party Relationships.. 8
- MRCG and MSRCG November 2021 Meetings 10
- MRCG-MSRCG Compliance Calendar .. 11

was under the impression that a transfer would only occur if the linked account had sufficient funds. This situation and the potential for a fee to be incurred due to the NSF in the linked account may have never been disclosed. A bank should review its system parameters and all related documents to make certain that any situation in which a customer may incur a fee are fully and completely disclosed.

Further, if the bank has set parameters so that transfers are in specified dollar increments, but transfers could still occur outside of those increments, this should be disclosed to consumers. If a transfer can occur even if it is not sufficient to cover the overdraft, the customer should be made aware of any harmful consequence such as transfer or overdraft fees, NSF creation in the linked account, etc. The bank's system parameters should be reviewed to ensure that all information and disclosures are complete and accurate. It may be necessary to adjust the system parameters or revise disclosures or other documentation. Additionally, reviewing complaints received is a good way to understand if disclosures and documentation are missing any relevant information or if any related issues are causing problems or concerns within the bank's customer base.

It may be necessary to revise disclosures, agreements and marketing materials to be sure all material information is included. Or, a bank may need to change its system parameters to match its disclosures and documentation. The FDIC reported that some banks have changed core settings to ensure that a transfer will occur only when beneficial to the customer, as in preventing an OD fee from being charged. Some others have eliminated the transfer fee so there is no additional charge associated with the linked account service. The bottom line is that it must be easy for consumers to understand any product or service offered by the bank and be aware of any situation or circumstance in which a fee may be incurred.

<Memrie Fortenberry>

PROPOSED SMALL BUSINESS LOAN DATA COLLECTION RULE

On September 1, 2021, the CFPB finally issued its long-awaited proposed rule to implement Section 1071 of the Dodd-Frank Act. Section 1071, which Congress enacted over ten years ago, amended the Equal Credit Opportunity Act to mandate reporting requirements for lenders making business loans. Specifically, Section 1071 requires banks to identify woman-owned, minority-owned, and small businesses and to collect data related to race, sex, and ethnicity of business owners, as well as the loan's purpose, the action taken on the loan, the business's gross annual revenue, and "any additional data" that would aid the CFPB in fulfilling the purposes of Section 1071.

Definitions

The proposed rule, which is over 900 pages long, would create a new subpart B to Regulation B, the implementing regulation for the ECOA. The proposed data collection requirements apply to "covered financial institutions", defined as financial institutions that have originated at least 25 covered credit transactions to small businesses in the last two calendar years. The rule defines "financial institutions" very broadly to apply to any entity that engages in small business lending, not just banks, saving associations, and credit unions. Similarly, the definition of "covered credit transaction" is broad and includes transactions that meet the definition of business credit under Reg. B, as well as loans,

lines of credit, and credit cards, among other activities.

The proposed rule defines "small business" in reliance upon the Small Business Administration's definition of "small business concern", which means any business that is independently owned and operated and that is not dominant in its field of operation. Also, for purposes of Section 1071, a small business must have no more than $5 million in gross annual revenue.

Additionally, the NPRM defines a "covered application" as "an oral or written request for a covered credit transaction that is made in accordance with procedures used by a financial institution for the type of credit requested." Lenders would be required to collect data on a calendar-year basis and report it to the CFPB by June 1 of the following year. The CFPB will publish the data it receives on its website. Covered financial institutions also must retain evidence of compliance for at least three years.

Data Points

So, what types of data would need to be collected under the proposed rule? For each covered transaction, covered financial institutions must collect the following:

- Unique identifier (to identify and retrieve specific files)
- Application date (the date the covered application was received by the lender)
- Application method (for example, online, in-person, etc.)
- Application recipient (whether the applicant submitted the application directly to the lender or via a third party)
- Credit types, including the credit product, the guarantees obtained, and the loan term
- Credit purpose (lenders can choose up to 3 purposes from a list of 5 options)
- Application amount
- Amount approved or originated
  - For closed-end credit approved but not accepted – the amount approved
  - For closed-end credit originated – the amount originated
  - For open-end credit originated or approved but not accepted – the amount of credit limit approved
- Action taken on the application
  - Originated
  - Approved but not accepted
  - Denied
  - Withdrawn by applicant
  - Incomplete
- Action taken date
- Denial reasons
- Pricing information, including:
  - Interest rate
    - If fixed, the applicable rate
    - If adjustable, the margin, index value, and index name
  - Total origination charges (expressed in dollars, the total amount of all charges payable directly or indirectly by the applicant and imposed directly or indirectly by the lender at or before origination as incident or condition to the extension of credit)
  - Broker fees (expressed in dollars, the total amount of origination charges that are fees paid by the applicant directly to a broker or to the lender for delivery to a broker)
  - Initial annual charges (expressed in dollars, the total amount of all non-interest charges scheduled to be

imposed over the first annual period of the transaction)

  - Additional cost for merchant cash advances or other sales-based financing (expressed in dollars, the difference between the amount advanced and the amount to be repaid)
  - Prepayment penalties (whether the lender could have included a charge to be imposed for paying the transaction's principal before the date on which the principal is due and whether the lender in fact did charge a prepayment penalty)

- Census tract (the location where the proceeds of the credit applied for or originated would be applied, and if unknown, the location of the main office or headquarters of the applicant or another location associated with the applicant)

Covered financial institutions must also collect the following information from each loan applicant:

- Gross annual revenue
- NAICS code
- Number of workers
- Time in business
- Minority-owned business status (defined as a business for which more than 50% of its ownership or control is held by one or more minority individuals and more than 50% of its net profits or losses accrue to one or more minority individuals)
- Women-owned business status (defined as a business for which more than 50% of its ownership or control is held by one or more women and more than 50% of its net profits or losses accrue to one or more women)
- Ethnicity, race, and sex of principal owners (defined as a person who owns at least 25% of the business)
- Number of principal owners

Lenders do not need to validate the demographic information from principal owners and cannot make the applicant provide it. However, lenders are required to provide information on the ethnicity or race of the principal owner based on the lender's observation, but only if the lender has a face-to-face meeting with the applicant, either in person or electronically with a video component.

"Firewall"

The proposed rule restricts the access to certain demographic information provided by an applicant from certain individuals, including underwriters, employees making a determination on an application, etc., at a lender or its affiliates.

Violations

Section 1071 violations may result in sanctions and civil liability. However, bona fide errors in compiling, maintaining, or reporting data are not subject to enforcement. A bona fide error is one that was "unintentional and occurred despite the maintenance of procedures reasonably adapted to avoid such an error."

Impact on Lenders

If finalized as written, the rule would create a comprehensive database of small business credit application to assist regulators and the public to identify and address fair lending issues with small businesses. It will also create reporting requirements as burdensome as those imposed by HMDA.

The CFPB is currently soliciting feedback on the proposed rule. Any comments are due by January 6, 2022, unless the comment period is

extended, which is certainly possible given the impact of this proposal. As proposed, the compliance date will be approximately 18 months after publication of a final rule in the Federal Register. We expect the rule will not be in place at least until sometime in 2023 with a compliance date at least 18 months later.

<Doug Weissinger>

A LITTLE BIT OF THIS AND THAT

We have received a variety of different questions from group members recently, and we thought it would be a good idea to share the discussion with all of you.

One issue has to do with error resolution and unauthorized transactions under Regulation E. The question has come up regarding who is responsible for refunding fraudulent or unauthorized transactions initiated through payment applications like Cash App, Venmo and others – is it the bank or the payment application provider? For example, a bank customer complains that the customer did not authorize a debit from his or her account through the Cash App. The ABA issued to its member banks an analysis that under Regulation E, a service like Cash App that provides an electronic funds transfer service to a consumer but does not hold the consumer's account is subject to all the requirements for error resolution if the provider:

Issues either a debit card or other access device that the consumer can use to access the consumer's account held by a financial institution; and

Has no agreement with the account-holding institution regarding such access.

It appears that CashApp has issued an access device. Under Regulation E, an access device is a card, code, or other means of access to a consumer's account that may be used by the consumer to initiate electronic fund transfers. It appears that CashApp has provided a "means of access" to the consumer's bank account, and CashApp does not have any agreement with the bank holding the consumer's account about this access. Payment service providers are subject to the requirements generally applicable under Regulation E, including liability for unauthorized transactions that exceed the consumer liability and the dispute resolution provisions.

This absolutely makes sense – HOWEVER, the CFPB has not "officially" given its opinion. So, stay tuned for the regulators' answer. In the meantime, a bank should consider any notice from a customer regarding an unauthorized transfer as triggering the Reg. E requirements for investigation and error resolution. Just because a transfer came through a third party provider does not mean the bank has no duty to investigate and respond within the time frames set out in Reg. E. We will keep you posted on anything we hear.

Another issue that has arisen involves assessment of late payment charges on loans. It may be time to take a new look at some of your loan documents and your system parameters. We are seeing some regulatory exams where examiners are looking at how and when a bank's system imposes a late charge and whether the system matches up with what the bank's loan documents say. Remember that in Mississippi, a late charge is permitted for delinquencies of "more than 15 days." Mississippi loan documents frequently

use language like "more than 15 days" or "16 days or more." Some loan systems appear not to be waiting the full 15 days, but they really are in that a late charge is imposed at the close of business on the 15th day assuming no payment was received. Others we have seen are not waiting the full 15 days before a late charge is assessed. Do some sample tests and make sure your system is calculating late charges properly, and that your loan documents accurately describe when a late charge may be assessed.

Also, there have been some questions regarding loan payment extension agreements. As a reminder, extension agreements should include the complete terms of the extension and inform consumers of the impact of the extension: for example, whether the bank will continue to accrue interest for the extension period; whether the amount extended will be due at the maturity of the loan; whether the maturity date will be extended; whether the repayment schedule will change; whether the amortization of the loan will change so that once payments resume more of the payment will go to interest before principal reductions resume; whether the final payment will be larger; whether more interest will be paid over the life of the loan; what is the impact on escrows for taxes and insurance; and what is the impact on any applicable credit life coverage. You also need to be clear as to whether the extension agreements you give the examiners are general loan extensions, or skip-a-payment agreements that are generally marketed at holiday times.

One other thing. Apparently, customers are asking banks how they can deposit cash without that "form" having to be completed. ☺ As a reminder, you cannot tell a customer how to structure deposits to avoid having a CTR filed. You can, however, give them one of the FinCEN notices "A CTR Reference Guide." The funny thing about this notice is that everything they have told banks they cannot do is included in this brochure – even complete with examples!! As long as you given them this notice, you are safe. You still file a SAR, though, if the customer reads what it means to structure funds though!

Flood insurance and cross-collateralization remains an examination issue which we have discussed previously. I will add that one of the November speakers is going to talk about flood insurance and cross-collateralization. We look forward to hearing directly from the regulators on this subject.

Until November, remember to check your documents if you have had a system update or if you have revised a form.

<Patsy Parkin>

GET READY FOR 1071

Who, besides me, likes the Temptations? One of my favorite Temptations songs is their 1966 hit "Get Ready." Elsewhere in this newsletter, Doug Weissinger outlines the CFPB proposal to amend Reg. B to implement Sec. 1071 of the Dodd-Frank Act which requires HMDA-like data collection and reporting for loan applications from women-owned, minority-owned and small businesses. The Bureau has proceeded in fits and starts over a 10 plus year period to get to the current point in issuing this proposed rule. The comment period expires January 6, 2022, unless extended. While the final rule may differ in any number of ways from the proposal, there is no doubt that a final rule will be forthcoming in the not so distant future, and it is time to get ready for it.

We think a final rule is likely sometime in 2023. If a final rule is adopted as proposed, there will be at least an 18-month

implementation period. If, for example, a final rule is published in June of 2023, data collection for covered institutions would begin January 1, 2025, with reporting of 2025 data to follow June 1, 2026. The Bureau has said it is considering whether to permit or require data collection for a partial first year, so, if a final rule is published earlier, it is possible we could see data collection begin sometime during calendar year 2024 with reporting of partial year data by June of 2025.

I do not believe it is possible to overestimate the challenges this rule will present or the impact it will have on bank small business lending. The time to begin planning is now, and any bank that does not take a holistic approach in developing a strategy for compliance with the rule stands an excellent chance of being one of the first to be targeted for a fair lending exam soon after the first dataset is reported. By holistic approach, I mean a bank should develop a comprehensive strategy for complying with the rule that takes into consideration not just the technical requirements and the various operational and compliance challenges that implementing those requirements will present, but also the impact that compliance may have on small business lending and bank loan policies and procedures. There will be a dramatic increase in the risk of fair lending enforcement actions following reporting of small loan data. A bank would be wise to review carefully its small business loan products, policies and procedures and take steps to mitigate any fair lending risk that is found long before data begins to be collected. Mitigation of fair lending risk could have a significant impact on the small business loan underwriting and pricing policies and procedures of many banks.

With respect to operational and compliance challenges, consider how the data will be collected with each loan application and by whom; whether a firewall to prevent improper consideration of monitoring information regarding race, gender or ethnicity of the business owners is feasible and, if so, how it will be implemented; how will the data be collated and reported and by whom; what file documentation will be required; what records must be maintained, where and for how long; just to name a few. Consider too, the compliance mindset of those persons who will necessarily be involved. How compliance oriented is the small business lending area of your bank? The lending personnel who will need to be involved in collecting and reporting this data may not have much prior experience dealing with compliance risk.

Consider also how implementation of the rule will affect the origination process for covered business loans. Many banks do not currently use a formal written application for business loans. Obviously, everyone has a process in place that works for them, but the process for many is relatively informal and may vary from loan officer to loan officer. As a practical matter, implementation of this rule will necessitate a much more formal and standardized process to ensure that all of the required data is collected, that the basis for credit decisions is fully documented, and that the data is input and maintained in a fashion that will allow it to be properly reported. A formal written application may be needed, and application intake and evaluation processes may need to be revised.

The primary stated purpose of Sec. 1071 of Dodd-Frank is to facilitate enforcement of fair lending laws. The CFPB and prudential bank regulators will quickly put to use the first reported data. They will use it to identify lenders with apparent lending disparities and target those institutions for more in-depth fair lending examinations. We saw that occur in

2004/2005 after rate spread information began to be reported with HMDA data, and again more recently with respect to HELOCs after HMDA reporting of HELOC data became mandatory. What will your reported data on small business loans look like?

The data points to be reported under the proposed rule are basic. If there are any significant differences in approval/denial ratios or in interest rates between minority and women-owned business applicants and other applicants, regulators will want to take a closer look in an exam at the bank's loan underwriting and pricing policies and practices. Any disparities that do exist will need to be justified, and that justification will depend on the ability of the bank to explain its underwriting and pricing criteria and demonstrate that it applies that criteria uniformly applied. In our experience, business loan policies and practices vary widely. Most banks operate judgmental credit decisioning processes. Lending officers sometime have broad discretion within their individual lending limits and bank underwriting and pricing guidelines are not always well defined. Discretion equates with increased fair lending risk.

Many banks have greatly improved and better defined their underwriting, pricing guidelines and exception criteria for consumer loans to improve consistency in credit decision making and pricing. If you have not already done so, now is a good time to do the same for small business lending. If adjustments are needed, you will want them in place and in use well before data begins to be collected. A fair lending risk assessment focused on small business lending would be a good place to start.

While you are reviewing the proposed rule and thinking about what will be required in order to comply, be sure to also consider the bigger picture. Make sure that small business lending is included in all aspects of your fair lending compliance risk management process. Get ready, because it is coming.

<Cliff Harrison>

PROPOSED GUIDANCE ON THIRD-PARTY RELATIONSHIPS

In July 2021, the Federal Reserve, the FDIC and the OCC issued proposed interagency guidance related to risk management of third-party relationships. The proposed guidance includes FAQs issued by the OCC in 2020 with a request for comments regarding whether or not the FAQs should be included in any final guidance. If adopted, the proposed guidance will replace previously issued related guidance. The guidance defines a third party relationship as "any business arrangement between a banking organization and another entity." The relationship can be defined through a contract or without. These may include relationships between a bank and its processors, vendors, fintechs, third party service providers, etc. The guidance provides that the use of a third party to perform duties for or on behalf of a bank does not reduce or do away with the bank's responsibilities for safety and soundness or compliance with applicable laws and regulations.

The guidance sets forth a "third-party relationship life cycle" that includes planning; due diligence and third-party selection; contract negotiation; oversight and accountability; and ongoing

monitoring. Banks should manage third-party risk at all stages of the cycle. The proposed guidance also provides that the strongest methods of managing third-party risk should be applied to those functions that are "critical" to the bank. Critical functions or activities are those that could create a significant risk, investment or consumer impacts upon failure of a third party to perform according to the bank's expectations.

The first several stages of the "third-party relationship life cycle" occur prior to entering into a relationship. The first, planning, includes identifying risks, benefits, costs, and staffing and technological needs required of the potential relationship. It also requires analyzing any impacts upon any areas of the bank as well as security implications. The planning process should involve individuals with expertise in all potentially affected areas of the bank. The next phase of the "life cycle" is to conduct appropriate due diligence based on the following factors: how the third party's strategy and goals may impact the proposed activity; the third party's ability to become and remain compliant with applicable laws and regulations; the third party's financial condition; the third party's experience with the proposed activities; related fees; evaluation of the third party's company management and principal's; review of the third party's risk management practices, information security and management information systems; and many other items specifically set forth in the proposed guidance such as insurance coverage, human resource management, use of subcontractors, etc.

Once a third party provider has been chosen by the bank, the specifics of the relationship should be determined and agreed upon. This stage of the "life-cycle" is contract negotiation. Through these negotiations, the bank should consider all of the factors set forth in the proposed guidance including, but not limited to the specifics regarding the nature and scope of the agreement between the parties; any applicable measures of performance and penalties for inadequate or unacceptable performance; responsibilities related to data access, sharing, security, etc.; right to audit; requirement for compliance with applicable laws and regulations; fees and other costs related to the agreement; third party's rights related to the use and access to the bank's information, property, technology and intellectual property as applicable; confidentiality; default and dispute resolution limitation of liability; handling of consumer complaints; etc. The proposed guidance provides a long list with specific information to be included or considered during contract negotiations.

Once an agreement is agreed upon and entered into, ongoing monitoring, review and reporting is necessary. Ultimately, the bank's board of directors and management are responsible for the oversight management of the risk related to third-party service providers. Ongoing monitoring is particularly important in third party relationships where the third party is engaged in critical activities which is any function or activity that could cause significant risk to the bank, could have significant consumer impacts, require significant investment of bank resources, or have a major impact on

bank operations if the bank had to find a replacement provider or bring the activity in-house. Many fintech and other relationships would likely fall in the critical activity category.

If the proposed guidance is finalized, we will discuss the final guidance at a future meeting.

<Memrie Fortenberry>

MRCG AND MSRCG NOVEMBER 2021 MEETINGS

The MRCG and MSRCG will hold combined November annual meetings on November 16 and November 18, 2021, using the Zoom online webinar format. We will continue our practice of dividing the agenda into two sessions each lasting about an hour and a half.

As is our tradition, we invited the regulators to speak at the annual meetings, and we are very pleased to announce that both the Federal Reserve and the FDIC graciously accepted our invitations.

The first session will be held beginning at 10:00 am on November 16 and will feature Everett Fields with the FDIC who will discuss fair lending and Kevin Henry with the Federal Reserve Bank of St. Louis who will speak about branching from a fair lending and CRA perspective.

The second session will begin at 10:00 am on November 18 and will feature Napoleon Yancy with the FDIC who will talk about hot topics and recent exam issues including overdrafts and flood insurance and Daniel Haggerty with the Federal Reserve Bank of Atlanta on various BSA/AML compliance issues. Specifics for accessing the webinars will be provided closer to the date. If there are specific questions on any of these topics you would like for us to ask them to address, email them to Patsy Parkin (Patsy.Parkin@butlersnow.com) and copy Liz Crabtree (Liz.Crabtree@butlersnow.com) as soon as possible. You will also be able to ask questions during the webinars using the chat feature. We look forward to seeing you all online.

<Cliff Harrison>

MRCG-MSRCG COMPLIANCE CALENDAR

03/01/2021 – CFPB rule revising standard QM definition effective (10/01/2022 mandatory compliance date);	02/17/2022 – MRCG February Quarterly Meeting
03/01/2021 – CFPB rule creating new seasoned loan QM loan category effective	02/22/2022 – MSRCG February Quarterly Meeting
05/03/2021 – CFPB change to Reg. F (FDCPA) regarding debt collectors and tenant eviction notices effective.	04/21/2022 - MRCG-MSRCG Joint Steering Committee meeting
8/31/2021 – Reg. X mortgage servicing rule providing temporary foreclosure protections effective.	05/19/2022 - MRCG May Quarterly Meeting
10/18/2021 – Comments due on proposed inter-agency guidance on managing 3rd party relationships	05/24/2022 - MSRCG May Quarterly Meeting
12/03/2021 – NFIP expiration date.	07/21/2022 - MRCG-MSRCG Joint Steering Committee meeting
11/16/2021 – MSRCG Quarterly Meeting	08/18/2022 - MRCG August Quarterly Meeting
11/18/2021 – MRCG Quarterly Meeting	08/23/2022 - MSRCG August Quarterly Meeting
11/30/2021 – Revised Reg. F (FDCPA) effective.	09/15/2022 - MRCG-MSRCG Joint Steering Committee meeting
01/01/2022 – HMDA open-end coverage threshold permanently adjusts to 200 loans	10/01/2022 – Mandatory compliance date for revised standard QM loans; GSE QM loan category removed
01/06/2022 – Comments due on proposed Reg. B changes for small business loan data collection/reporting.	11/15/2022 – MSRCG November Quarterly Meeting
01/20/2022 – MRCG-MSRCG Joint Steering Committee meeting	11/17/2022 - MRCG November Quarterly Meeting