



BANKING ON A SOLID FOUNDATION

COMPLIANCE PIPELINE

July 31, 2011

Volume IV, Issue II

Significant RESPA Change!!

Current RESPA rules prohibit a bank from charging any fee (other than the fee covering the cost of a credit report) until after the good faith estimate (GFE) disclosure was delivered to the consumer in response to receipt of a covered application. Effective August 10, 2011, banks will not be able to charge for any item other than a credit report until after the customer has received a good faith estimate (GFE) disclosure and has indicated their intent to continue with the loan application. While most loan platform form vendors already have forms available to assist

banks with documenting a borrower's intent to proceed, RESPA previously did not state that an intent was required to be obtained once the good faith estimate was deemed received by the applicant. It is recommended that financial institutions implement procedures for having customers affirmatively state and document their intent to proceed with the loan application once the good faith estimate is provided and before any fee other than a credit report fee is charged to ensure future compliance.

Dodd-Frank Act & FCRA Force Changes for Adverse Action Notices

Notice of Action Taken model forms have been revised to reflect the new requirements in Section 615(a) of the Fair Credit Reporting Act (FCRA) as amended by the Dodd-Frank Act (DFA). The new model forms included in the appendix to Regulation B will meet the requirements for both ECOA and FCRA adverse action provisions as there is no additional implementing regulation for Section 615(a) of the FCRA. The DFA became legally effective as of July 21, 2011; however, this final rule will become effective August 15, 2011.

The new model forms generally contain a statement of use of a credit score, the credit reporting agencies contact information, a numerical credit score used in making the credit decision, the range of possible scores under the model used, up to four key factors that

adversely affected the consumer's credit score (or up to five factors if the number of inquiries made with respect to that consumer report is a key factor), the date on which the credit score was created, and the name of the person or entity that provided the credit score.

The above mentioned disclosures are required when a bank utilizes a credit score in an adverse action decision. The DFA further provides that unless the credit score played no role in the adverse action decision, a bank must provide the new notices even if the credit score played an insignificant role. A bank does not have to utilize a formal minimum credit score in its underwriting to trigger compliance with this rule. Supplementary information to the rule discusses banks that use a judgmental system for credit analysis.

Inside this issue:

SCRA NOTICE UPDATE	2
REG V CHANGES	3
S.A.F.E. ACT RECAP	3
REG Q REPEALED	5
OCC ODP GUIDANCE	6

Compliance Pipeline

Dodd-Frank Act & FCRA Force Changes for Adverse Action Notices

(Continued from Previous Page)

Per the supplement, a bank may still use the language in the model form stating that it “used” a credit score when there is ambiguity relative to whether a credit score obtained was considered in the judgmental evaluation. Therefore, banks that use the judgmental credit system and take an adverse action based on credit related information from a credit report the new FCRA disclosures are required. However, if the adverse action is not based on information from the credit report (no credit file, employment related reasons, collateral related reasons, residence related reasons, etc.) in any way these disclosures are not required.

Supplemental information to the final rule made it clear that the new FCRA disclosures are separate and different from any current requirements under the FCRA. Credit score risk based pricing exception notices (for banks not providing the general risk based pricing notice) provided to each consumer and section 609(g) notices (Notice to Home Loan Applicant & Credit Score Disclosure) contain similar information to be disclosed but are separate regulatory requirements and should continue to be provided as required. The credit score exception notices and section 609(g) notices may not be combined with, or substituted for, the FCRA adverse action notices.

The Federal Reserve Board further clarified that the key factors required to be disclosed by the FCRA do not alone satisfy the ECOA requirements for providing an applicant with the principal reasons for the adverse action taken. While the principal reasons for adverse action and the key factors affecting a consumer’s credit score may be related in some instances, they are not always directly correlated and are required under separate regulatory requirements. Banks are required to continue to list the principal reasons for denial on the notice in addition to meeting the new disclosure FCRA requirements.

For adverse actions involving joint applicants, banks should provide separate notices to each applicant with FCRA credit score disclosures including only that individual’s information. However, the notices sent to each borrower should disclose the same principal reasons for denial of the joint appli-

cation as required under ECOA. Many banks obtain multiple credit scores to make a single credit decision. When a bank obtains multiple scores but only uses one score, the bank must disclose that the information relating to the score used. If a bank utilizes a credit report with multiple scores, it should have policies and procedures that indicate which score will be used (lowest, highest, most recent, etc.) in order to also comply with the disclosure requirements. If a bank uses an average score approach any one score and related information may be disclosed to meet this requirement.

These new adverse action disclosure requirements are not simply limited to credit denials. If a bank denies a consumer relative to opening a deposit account or a service such as a debit card and the action was based on a credit score the FCRA disclosures must be given. The FCRA’s definition of a “consumer” is an individual; therefore, a bank may have some “commercial” or “business purpose” credit denials which would be required to be provided the above mentioned FCRA adverse action notice. For complete guidance from the Federal Reserve Board read the following final rule:

<http://www.federalreserve.gov/newsevents/press/bcreg/20110706a.htm>

Updated Servicemember Civil Relief Act Notice

HUD has updated the form HUD-92070 as of June of 2011. This notice must be provided to all homeowners whether they are in the service or not, when they are in default since it is impossible for a bank to know whether borrowers are protected under the SCRA. The notice must be sent within 45 days of the homeowner’s mortgage becoming delinquent unless the loan has since paid current. In many instances, the SCRA Notice is mailed with the HUD Homeownership Counseling Notice. Each bank should take steps to ensure that the current notice is provided as required. The following link provides an updated notice:

http://www.bankersonline.com/tools/hud_scrs_2011-06.doc

Additional model disclosures required by Regulation V – Fair Credit Reporting

Once again the Dodd-Frank Act (DFA) has implemented changes to Regulation V, Fair Credit Reporting. The changes have resulted in two new model forms to be used when a credit score is obtained to set a transaction's terms or to increase APRs on existing accounts. Since the DFA is self-implementing it became legally effective as of July 21, 2011. However, the final rule under Regulation V will become effective August 15, 2011.

Most community banks have opted to provide the credit score exception notices instead of the general risk based pricing notices. However, if a bank is using the general notice approach new model form H-6 should be used if a credit score is used in setting the material terms of credit. Further, new model form H-1 should be used in complying with the general risk-based pricing notice requirements in Section 222.72 if a credit score is not used in setting the material terms of credit. If a bank has chosen the exception notice approach, no changes to procedures are necessary. However, if the bank has taken the general notice approach, these new forms should be utilized as applicable.

S.A.F.E. Act Recap!!

Under the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act) and the agencies' final rules, residential mortgage loan originators employed by banks, savings associations, credit unions, or Farm Credit System institutions must register with the registry, obtain a unique identifier from the registry, and maintain their registrations. Following expiration of the 180-day initial registration period on July 29, 2011, any employee of an agency-regulated institution who is subject to the registration requirements will be prohibited from originating residential mortgage loans without first meeting these requirements. The rules include an exception for mortgage loan originators that originated five or fewer mortgage loans during the previous 12 months and who have never been registered. Such personnel are not required to complete the federal registration process. If loan officers have not already registered and obtained their unique identifier from the registry, this should be a top pri-

A change that will affect all banks is the addition of another model form required relative to the account review process if an account APR is increased. Section 222.72(d) of Regulation V states that a bank must provide a risk-based pricing notice to a consumer if it uses a consumer report in connection with a review of an existing credit account and subsequently increases the APR. The Federal Reserve Board has provided banks with two model forms to choose from to meet this requirement. Model form H-7 is for risk-based pricing notices given in connection with an account review if a credit score is used in increasing the APR while model form H-2 is for risk-based pricing notices given in connection with an account review if a credit score is not used.

For banks that use a judgmental credit system to decide when to increase the APR based on credit related information from a credit report, the new Model form H-7 is required to be provided. However, if the APR increase is not based on information from the credit report in any way (i.e. no credit file, employment related reasons, collateral related reasons) then model form H-2 should be used instead.

ority. Additional information on registration can be found at the following link:

<http://mortgage.nationwidelicencingsystem.org/fedreg/Pages/default.aspx>.

All banks must develop and approve written policies and procedures that at a minimum cover the requirements of section 104 of this part, which includes the following: (a) Establish a process for identifying which employees of the bank are required to be registered mortgage loan originators; (b) Require that all employees of the insured State nonmember bank who are mortgage loan originators be informed of the registration requirements of the S.A.F.E. Act and this subpart and be instructed on how to comply with such requirements and procedures; (c) Establish procedures to comply with the unique identifier requirements in § 365.105; (d) Establish reasonable procedures for confirming the

Compliance Pipeline

S.A.F.E. Act Recap!!...(Continued from Previous Page)

adequacy and accuracy of employee registrations, including updates and renewals, by comparisons with its own records; (e) Establish reasonable procedures and tracking systems for monitoring compliance with registration and renewal requirements and procedures; (f) Provide for independent testing for compliance with this subpart to be conducted at least annually by bank personnel or by an outside party; (g) Provide for appropriate action in the case of any employee who fails to comply with the registration requirements of the S.A.F.E. Act, this subpart, or the bank's related policies and procedures, including prohibiting such employees from acting as mortgage loan originators or other appropriate disciplinary actions; (h) Establish a process for reviewing employee criminal history background reports received pursuant to this subpart, taking appropriate action consistent with applicable Federal law, including section 19 of the Federal Deposit Insurance Act (12 U.S.C. 1829) and implementing regulations with respect to these reports, and maintaining records of these reports and actions taken with respect to applicable employees; and (i) Establish procedures designed to ensure that any third party with which the bank has arrangements related to mortgage loan origination has policies and procedures to comply with the S.A.F.E. Act, including appropriate licensing and/or registration of individuals acting as mortgage loan originators.

Further, banks must make the unique identifiers of its registered mortgage loan originators available to consumers in a practicable method. Supplementary guidance to the final rule goes on to state that the bank may accomplish this in several ways: a bank may choose to direct consumers to a listing of registered mortgage loan originators and their unique identifiers on its Web site; post this information prominently in a publicly accessible place, such as a branch office lobby or lending office reception area; and/or establish a process to ensure that institution personnel provide the unique identifier of a registered mortgage loan originator to consumers who request it from employees other than the mortgage loan originator.

The unique identifier number must be disclosed in several instances. A registered mortgage loan origi-

nator shall provide his or her unique identifier to a consumer (1) Upon request; (2) Before acting as a mortgage loan originator; and (3) Through the originator's initial written communication with a consumer, if any, whether on paper or electronically. Effective immediately, loan officers will be required to provide their unique identifier upon request to any consumer that makes a request and before any loan is originated by including the number on the credit application. In addition, banks should have procedures in place for disclosing the unique identifier with each adverse action notice provided to the customer as this will be the first written communication in most cases when a loan is denied. Initial RESPA disclosures may be the first written communication with the consumer and should also be accompanied by the unique identifier. It is recommended that loan officers provide a cover letter with initial disclosures that provides the unique identifier.

Many banks have already started implementing several best practices for providing the unique identifier:

- Including the unique identifier in all advertising that contains a specific loan officer name,
- Including the unique identifier in email or other written correspondence,
- Including the unique identifier on loan officer business cards, and
- Including a list of loan officers on the bank's website with corresponding unique identifiers.



Regulation Q Repealed

The Federal Reserve Board recently announced the approval of a final rule to repeal its Regulation Q, which prohibits the payment of interest on demand deposits by institutions. The final rule implements Section 627 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which repeals Section 19(i) of the Federal Reserve Act in its entirety effective July 21, 2011. The repeal of that section of the Federal Reserve Act eliminates the statutory authority under which the Board established Regulation Q. The rule also repeals the Board's published interpretation of Regulation Q and removes references to Regulation Q found in the Board's other regulations, interpretations, and commentary.

Regulation Q (Prohibition against Payment of Interest on Demand Deposits) and Regulation D (Reserve Requirements of Depository Institutions) are two regulations that examiners generally refer to when conducting the deposit operations segment of consumer compliance examinations. Regulation D contains definitions for the various categories of deposit accounts (transaction, demand, time, and savings) and places certain types of accounts, such as NOW accounts and money market deposit accounts, within those categories. Regulation D also explains how depository institutions must classify different types of deposit accounts for the purpose of complying with reserve requirements, an integral tool in implementing monetary policy.

However, the NOW account eligibility requirements under Regulation D have not been repealed and will remain in place. A depository institution is authorized to permit the ownership of a NOW account only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, political or other similar purposes and which is not operated for profit, and with respect to deposits of public funds. Therefore, banks should continue to screen new customers at account opening to ensure that they are in fact eligible to obtain a NOW account product. This essentially gives banks more flexibility to meet customer needs while also complying with these regulations.

Under a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the FDIC provides unlimited deposit insurance for

noninterest-bearing transaction accounts through December 31, 2012. If on or after July 21, 2011, a Depository Institution modifies the terms of a DDA so that the account may pay interest, the institution must notify affected customers that the account no longer will be eligible for unlimited deposit insurance coverage as a noninterest-bearing transaction account. The final rule imposes certain notice requirements, including the requirement that if a bank modifies the terms of a deposit account so that the account no longer will be eligible for unlimited deposit insurance coverage, the institution "must notify affected customers and clearly advise them, in writing, that such actions will affect their deposit insurance coverage." This notice requirement is intended primarily to apply when Banks begin paying interest on demand deposit accounts (DDAs) under section 627 of the Dodd-Frank Act. Some industry experts are encouraging banks to review DDA account agreements for non-interest bearing accounts to ensure that language is included specifying that interest will not be paid (since it is no longer illegal) to avoid any potential conflict with expanded insurance coverage under the DFA.

The FDIC has not imposed specific requirements as to the form of the notice. Rather, the FDIC expects banks to act in a commercially reasonable manner and to comply with applicable state and federal laws and regulations in informing depositors of changes to their account agreements. The notice requirement for noninterest-bearing transaction accounts that convert to interest-bearing accounts does not apply to DDAs modified after December 31, 2012. As of January 1, 2013, all transaction accounts, whether they pay interest or not, will be insured up to the standard maximum deposit insurance amount, which currently is \$250,000.

Some banks may consider developing a new interest bearing DDA product to meet customer demand for such accounts. However, a bank should ensure that procedures are in place to notify customers of the insurance changes for existing accounts modified from a non-interest bearing to interest bearing account. A bank should also ensure that all customer service representatives are fully trained on the NOW account eligibility requirements as well as possible insurance ramifications for choosing an interest bearing account over a non-interest bearing account.

Compliance Pipeline

OCC Proposed Overdraft Privilege Guidance

The OCC has issued proposed guidance to clarify the application of principles of safe and sound banking practices in connection with automated overdraft protection and direct deposit advance programs. The OCC expects national banks to follow this proposed guidance in connection with any deposit-related consumer credit product to address potential operational, reputational, compliance, and credit risks.

The OCC proposal, like the FDIC Guidance, applies only to automated and not *ad hoc* overdraft protection programs. Unlike the FDIC Guidance, the OCC proposed rule addresses open-end deposit advance programs. While the OCC proposal is more general and less detailed than the FDIC Guidance, the OCC cautions national banks against undue reliance on fees generated by such products and states that it is concerned with imposition of fees that cumulatively exceed a customer's overdraft credit limit. For these reasons, the OCC expects national banks to develop policies and procedures governing automated retail overdraft protection programs that implement both this guidance and the 2005 Joint Agency guidance on Overdraft Protection Programs, including the section entitled "Best Practices" as applicable.

One initial requirement of the proposal is that customers should be provided pertinent information about alternative overdraft services and credit products, if any, offered by the bank. In addition to receiving cost information, customers should receive clear disclosures about the order of processing transactions as well as a notice when overdraft protection is suspended or terminated, and when it is reinstated.

Unlike the FDIC's Final Guidance, the OCC's proposal would make the payment of all overdrafts, including those arising from check and ACH transactions, subject to an opt-in requirement and therefore require the consumer's affirmative consent before *any* overdraft fee may be imposed. Banks are also expected to complete an initial assessment of the customer's risk as it relates to the overdraft products. Such an assessment should ensure the bank does not expose itself to undue risk and could be accomplished by reviewing credit reports or deposit account repositories consistent with prudent banking practices. National banks should establish

prudent limitations on the amount of credit that may be extended under an overdraft protection program including the number of overdrafts and the total amount of fees that may be imposed per day and per month, and any transaction amount below which an overdraft fee will not be imposed. In addition, the OCC suggests that a grace period of one or more days should be implemented to allow a customer to return the account to a positive balance before any overdraft fee is imposed.



Per the guidance, these limitations should be clearly disclosed to customers at the time the product is offered. In addition, it should be clearly disclosed to the customer that they can opt-out of the overdraft protection program at any time. The order in which transactions will be processed should be subject to standards to ensure that transaction processing is not solely designed or generally operated to maximize overdraft fee income. While the OCC does not specifically criticize all high-to-low processing orders, the proposal states that a bank's processing order should not be solely designed or generally operated to maximize overdraft fee income. A neutral processing order is suggested as a way to ensure compliance with this part of the guidance (e.g. by check or serial number, in order received, or random selection).

Accounts should be subject to monitoring and segmentation by customer usage to detect indications of excessive overdrafts (and related overdraft protection fees) and/or potential changes to repayment ca-

OCC Proposed Overdraft Privilege Guidance...(Continued from Previous Page)

capacity with respect to the overdraft product. A bank should determine whether accounts continue to be feasible or whether credit and aggregate fee limits need to be reduced, and take appropriate action as applicable. Such a determination should include a more in-depth analysis of the borrower's ability to manage and repay overdraft protection. The customer also should be notified of alternatives to overdraft protection, such as linked deposit accounts or other lines of credit. After account review and making any appropriate changes, the privilege should be suspended or terminated when the customer no longer meets the eligibility criteria, has declared bankruptcy, or is in default on repayment of an overdraft or on any other loan with the bank. If an account has been continually overdrawn for 60 days or more, it must be closed and charged off.

In addition, the OCC provides guidance on deposit advance products (short-term, open-end lines of credit that are generally made available to retail account holders with recurring direct deposits) but does not include any specific fee limits among the prudential limitations banks should establish. However, it does state that banks should establish limits on the number of periods that back-to-back advances can be made before a "cooling-off" period, the number of months in which advances may be outstanding, the

total amount or percentage of any deposit that may be advanced in any period and the total amount or percentage of any deposit that may be used to repay an advance. The guidance directs banks to permit advances that are substantial relative to the regular deposit amount to be repaid in multiple installments over more than one month.

It is important that bank management ensures that regular reports on overdraft volume, profitability, and credit performance are received and reviewed to identify excessive overdraft protection usage. By contrast to the FDIC final rule, the OCC rule appears to be more focused with safety and soundness considerations. A final rule is expected to implement most, if not all of these requirements for automated overdraft protection programs and deposit direct deposit advance programs, and therefore this guidance should not be taken lightly and proactive steps toward the implementation of this guidance should be taken to ensure the timely implementation of appropriate controls.

All national banks should immediately review this guidance and begin planning for implementation of its best practices upon passing of the final rule.

Email us at compliancnewsletter@shpco.net with any questions or comments.

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