Volume 8, Issue 5, October 2015

Practical Compliance

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In This Issue

Compliance System or Program? What? Huh?

How are you doing on the implementation of the new Loan Estimate and Closing Disclosure? Did your institution swing into action with a process already in place and a culture to support the process? If so, great! Or, are you once again trying to deal with major changes and deadlines on your own, starting from scratch? Maybe this is the time to consider stepping back, and looking again at the basics, to be prepared for next time.

The Consumer Financial Protection Board has pushed the need for compliance systems. In a news release in August 2013, the CFPB expressed concern at the lack of structure in compliance saying, "The CFPB expects the companies it supervises – regardless of size – to have fully developed compliance management systems to ensure all federal consumer financial protection laws are followed. A good system ensures that employees know about their responsibilities, creates structures for reviewing operations, and takes corrective actions when needed. A good system also lessens consumer risks and reduces the potential for violations." This is not new.

Back in the late 1990's when some of us were hitting our stride, and some were still in school, the OCC and the FDIC each published a document describing the expectations for a Compliance Management System. The CFPB, and other regulators, have similar language in their respective current exam manuals. The "system" is the overall concept and culture of compliance at the institution. Within the system is the more specific "program" to get the job done. Let's talk a bit about both.

In considering this article, I went to Google, just to see what was there. After finding some documents, I asked to see "images" of a Compliance Management System. Oh my! Every industry has one, or a hundred. All sorts of charts, graphs, maps, and games have been assembled to show a CMS, from four simple blocks to a schema that would make my Latin teacher proud. So no charts here, though we do have them if you ask.

First we'll summarize, according to your regulators, why the CMS is important. Next we'll describe the basic components. We'll get into the elements at the program level. Those of you who have been at this for years can consider it a refresher. Those of you who recently acquired your Compliance Officer hat may what to hang onto this edition of **Practical Compliance**.

Compliance Management Systems

The key word here is "Management". The system has to start at the very top with the tone set to infuse the culture of the organization. Without an expectation at senior levels for management of compliance risk, the chance of success at the program level is greatly reduced. The Federal Reserve noted the special challenges for compliance in a staff letter in 2008 regarding Compliance Risk Management (SR 08-8/CA 08-11).

> While the guiding principles of sound risk management are the same for compliance as for other types of risk, the management and oversight of compliance risk presents certain challenges. For example, quantitative limits reflecting the board of directors' risk appetite can be established for market and credit risks, allocated to the various business lines within the organization, and monitored by units independent of the business line. Compliance risk does not lend itself to similar processes for establishing and allocating overall risk tolerance, in part because organizations must comply with applicable rules and standards. Additionally, existing compliance risk metrics are often less meaningful in terms of aggregation and trend analysis as compared with more traditional market and credit risk metrics.

The CFPB Supervision and Examination Manual clearly reflects those of the other regulators. Because the Bureau is taking the lead on so many topics, that is the source used here. According to the CFPB, and similarly articulated by other regulators, a compliance management system is essential; however, it may be structured based on the size and complexity of the entity. The CFPB describes the essentials.

> A compliance management system is how a supervised entity:
> • Establishes its compliance responsibilities;
> • Communicates those responsibilities to employees;
> • Ensures that responsibilities for meeting legal requirements and internal policies are incorporated into business processes;
> • Reviews operations to ensure responsibilities are carried out and legal requirements are met; and
> • Takes corrective action and updates tools, systems, and materials as necessary.
>
> An effective compliance management system commonly has four interdependent control components:
> • Board and management oversight;
> • Compliance program;
> • Response to consumer complaints; and
> • Compliance audit.
>
> When all of these four control components are strong and well-coordinated, a supervised entity should be successful at managing its compliance responsibilities and risks.

Notice that the compliance program is just one of the four components. When examiners come to your institution, they will be looking at all four, with oversight first, then the program, and how you respond to both consumer complaints and audits. Of course, some of that response will be built into your program. Keep in mind also that the process of compliance is far from linear; it just keeps going around and around as regulations, issues, products and people change. Or, just when you think there is light at the end of the tunnel, you hear the whistle blow from the next train.

CMS Component: Oversight

The oversight must come from both the Board and senior management. That doesn't mean they aren't going to delegate, but it is up to them to stay informed, ask questions, and set expectations. The CFPB looks for eight activities with a wide scope. In summary, they must:

- Set clear **expectations** about compliance, both for the institution and also for service providers.
- Adopt clear **policy statements**.
- Appoint an appropriately qualified and experienced chief **compliance officer**.
- Establish a **compliance function** to set policies, procedures, and standards.
- **Allocate resources** to the compliance function.

- **Address compliance issues** and associated risks of harm to consumers throughout product development, marketing, and account administration, and through the entity's handling of consumer complaints and inquiries.
- Require **audit coverage** of compliance matters and review the results of periodic compliance audits.
- Provide for **recurring reports** of compliance risks, issues, and **resolution**.

CMS Component: Compliance Program

This is an entire topic in itself. This is the day to day, every day, process of compliance. Get the basics of your program written down and don't let it gather dust. Maybe you can start with your own job description, but get a team to work on it. The CFPB says in the Manual:

> A supervised entity should establish a formal, written compliance program, and that program generally should be administered by a chief compliance officer. In addition to being a planned and organized effort to guide the entity's compliance activities, a written program represents an essential source document that may serve as a training and reference tool for employees. A well planned, implemented, and maintained compliance program will prevent or reduce regulatory violations, protect consumers from non-compliance and associated harms, and help align business strategies with outcomes.

The key elements to the Compliance Program are policies and procedures, training, and monitoring and corrective actions. Of course those elements cover a lot of territory with a wide variety of activities.

Comprehensive policies and procedures should be up to date, be consistent with what your Board has approved, cover all relevant regulations, and comprise the full life cycle of the products and services offered.

The training program should be documented and current. Training should be provided across the institution from the Board and management to staff, from the front office to the back office, and don't forget ongoing training for the Compliance Officer and staff. Training should be tailored to the audience and to your own products, documents, policies and procedures.

Monitoring and testing is generally more frequent and less formal than compliance audit coverage and reporting, may be carried out by the business unit, and does not require the same level of independence from the business or compliance function that an audit program does. It may be daily quality control, or programmed compliance testing, but it must be based on the assessment of risk for the area or topic, and then tracked for corrective action. Monitoring is to confirm compliance both with regulatory requirements, and also with your own policies and procedures.

CMS Component: Complaint Management

As any retailer knows, those who are happy don't say a word, but those with a complaint tell everyone. Your response to complaints tells a lot about how effective your management is in general and especially for compliance. According to the CFPB, "An effective compliance management system should ensure that a supervised entity is responsive and responsible in handling consumer complaints and inquiries. Intelligence gathered from consumer contacts should be organized, retained, and used as part of an institution's compliance management system." If you don't have a documented process for consumer complaints, that document should move higher up your to-do list.

Your complaint procedures should cover the gathering and categorization of complaints and inquiries, should cover both the institution and your service providers, should include tracking for prompt resolution, and assign responsibilities along with criteria for escalating issues with legal, UDAP or Fair Lending implications. Data from complaints must be evaluated in order to address any weaknesses in your programs. Results of evaluations should be regularly reported to Management and the Board.

CMS Component: Audit Management

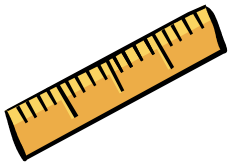
The final component is the essential independent observer. According to the CFPB, "A compliance audit program provides a board of directors or its designated committees with a determination of whether policies and standards adopted by the board to guide risk management are being implemented to provide for the level of compliance and consumer protection established by the board. The audit should also identify any significant gaps in board policies and standards."

Audits should be timely, risk based, appropriately reported to business managers and the Board, and should lead to appropriate and timely corrective action.

What to do…

A good system takes time to develop. First comes the commitment to do it. Campaign for time and support. M&M Consulting can help. Seriously, we've got your back.

Short Clips



CFPB Amends Important Reg. Z Definitions

On September 21, the CFPB issued a final rule, effective January 1, 2016, amending Regulation Z to revise the definitions of Small Creditors and Rural or Underserved Areas. The changes affect Ability-to-Repay, high-cost mortgage, and higher-priced mortgage loan (HPML) escrow requirements, but not the "rural county" definition applicable to appraisals or the requirement to obtain a second appraisal for HPMLs. In brief, the changes are as follows:

Small Creditor

- A small creditor will be one that, together with any affiliates, originates up to 2,000 first-lien covered transactions (rather than 500).
- Loans kept in portfolio will be excluded from the 2,000 loan limitation.
- Assets of affiliates that regularly extend first-lien covered transactions are included within the $2 Billion (adjusted annually) limit used to determine small creditor status

Rural or Underserved Areas

- The time period used to determine whether a creditor is operating predominantly in rural or underserved areas is reduced from any of the three preceding calendar years to the preceding calendar year.

A rural area will include either:

- a county that meets the current definition of a rural county; or
- a census block that is not in an urban area as defined by the U.S. Census Bureau.

New safe harbors are provided for determining whether a property is located in a rural area. A lender may rely on an address look up tool on the Census Bureau's website or a tool on the CFPB's website. Printouts will be available from these sites to document safe harbor protection. The current safe harbor for reliance on the county lists available on the Bureau's website will continue.

The CFPB has posted a summary of the new rule in the implementation section at the CFPB.

Private Mortgage Insurance–CFPB Summary

The CFPB published a handy Bulletin on August 4, of the requirements under the Homeowners Protection Act of 1998 regarding the cancellation and termination of private mortgage insurance. The requirements at 80% and at 78% of the original value are well described. The CFPB points out, "Supervision has identified violations of this provision in one or

more examinations, both for borrowers who were current on the 'termination date' and for borrowers who were delinquent on the 'termination date' but later became current. The CFPB encourages servicers to be mindful that in contrast to the cancellation date, the termination date does not permit a mortgage holder to require evidence of the property's current value, nor is a servicer required to determine the actual principal balance based on actual payments."

Consumer Compliance Outlook

The Federal Reserve published the 7th anniversary edition of their quarterly Consumer Compliance Outlook, which is free online and easily downloaded. We highly recommend this issue and the entire series. This edition contains a thorough article on "Managing Risk Throughout the Product Life Cycle". While similar articles have been published from a safety and soundness perspective, this one focuses on compliance risk. As the conclusion says, "Innovation, market conditions, and consumer demand will always lead to new products and services in the financial services industry. The institutions that are most successful in introducing new products and services consider consumer compliance risk throughout the product life cycle. This framework considers various institutional, legal and regulatory, and environmental risk factors that may be present at each life cycle stage of the product or service."

NCUA Revises Small Entity Threshold

The NCUA Board issued a final rule in the Federal Register on September 24 amending Interpretive Ruling and Policy Statement (IRPS) 87-2. The amended IRPS increases the asset threshold used to define the term "small entity" under the Regulatory Flexibility Act (RFA) from $50 million to $100 million. This is the requirement that agencies consider the impact on small entities when proposing rules and regulations. The final rule and IRPS also makes a technical change to NCUA's regulations in connection with procedures for developing regulations. The revision is effective November 23, 2015.

CFPB Amends Reg. Z Thresholds

This final rule, published in the Federal Register on September 21, reviews the dollar amounts threshold provisions for credit cards, HOEPA high cost loans, and Qualified Mortgages. These amounts are adjusted, where appropriate, based on the annual percentage change reflected in the Consumer Price Index in effect on June 1, 2015.

No change is made to the minimum interest charge disclosure thresholds for credit cards in Sections 1026.6(b)(2)(iii) and 1026.60(b)(3). Changes will apply to various other sections of Reg. Z, including the penalty safe harbors for credit cards in Section 1026.52(b)(1)(ii)(A) and (B); the HOEPA high cost thresholds in Section 1026.32(a)(1)(ii), and the corresponding Qualified Mortgage thresholds in Section 1026.43(d)(3)(ii). Changes are effective January 1, 2016.

OFAC Revised Regulations on Cuba

The Office of Foreign Assets Control (OFAC) published a final rule in the Federal Register on September 21, which revises and removes some of the regulatory sanctions regarding Cuba. The rule was effective the same day published. This appears to be another round of relaxing sanctions similar to those we noted in the February (Vol8Iss1) **Practical Compliance**. Included in those restrictions have been bank related items, now relaxed or removed.

- OFAC is removing the limitation on donative remittances to Cuban nationals who are not prohibited officials of the Government of Cuba or prohibited members of the Cuban Communist Party.
- Various previously blocked remittances are now released and may be returned.
- OFAC is removing the cap on permitted deposits to more adequately allow Cuban nationals lawfully present in the United States to access sufficient funds for living expenses or other transactions ordinarily incident to their presence in the United States in a non-immigrant status or pursuant to other non-immigrant travel authorization issued by the U.S. government.
- A new general license is put in place to permit remittances from Cuba to accounts in the US.
- A new general license will make settling decedents' estates easier.

Numerous other changes were made regarding travel and commercial activities and communications.

Proposals–Not Final Rules

BSA applicable to Financial Advisors

This proposal is not directly related to our usual consumer regulations; however, the proposal and discussions around it have been either in the news or ads recently, so we are including it for your information. On September 1, the Financial Crimes Enforcement Network ("FinCEN"), published a notice of proposed rulemaking to prescribe minimum standards for anti-money laundering programs ("AML") to be established by certain investment advisers and to require such investment advisers to report suspicious activity to FinCEN pursuant to the Bank Secrecy Act ("BSA"). FinCEN is taking this action to regulate investment advisers that may be at risk for attempts by money launderers or terrorist financers seeking access to the U.S. financial system through a financial institution type not required to maintain AML programs or file suspicious activity reports ("SARs"). The investment advisers FinCEN proposes to cover by these rules are those registered or required to be registered with the U.S. Securities and Exchange Commission ("SEC"). FinCEN is also proposing to include investment advisers in the general definition of "financial institution" in rules implementing the BSA. Doing so would subject investment advisers to the BSA requirements generally applicable to financial institutions, including, for example, the requirements to file Currency Transaction Reports ("CTRs") and to keep records relating to the transmittal of funds. Finally, FinCEN is proposing to delegate its authority to examine investment advisers for compliance with these requirements to the SEC.

The comment period closes on November 2.

In the States

New Hampshire Interest Payable on Escrows

The Bank Commissioner has announced the new interest rate to be paid on mortgage escrow accounts, effective August 1, 2015. The new minimum interest rate is **0.00%** and shall remain in effect until the next rate change, effective February 1, 2016. This is consistent with prior rates.

You may also find this announcement on the State of NH - Banking Department's web site at www.nh.gov/banking or the NHBA web site at www.nhbankers.com.

Vermont Privacy Regulation

The Department of Banking in Vermont proposes to amend its Regulation B-2001-01 regarding Privacy of Consumer Financial and Health Information. The proposed changes will 1) Provide some guidance on how entities can use the Federal Model Privacy Form in a manner that is consistent with Vermont's opt-in requirement. 2) Allow an alternative method for providing annual privacy notices, similar to the federal privacy regulation. 3) Update the name of the Department and correct statutory references.

A hearing is scheduled October 23, 2015, and written comments are due by October 30, 2015. Questions should be addressed to Sue.clark@vermont.gov .

Good To Know

Send your questions to the answerperson@mmconsulting.info

Sending requests to the above address gets you a written response to your questions. Emails sent to the answer person are received five days a week.

Q: A question has come up regarding the permissibility of having a "closed list" of settlement attorneys for mortgage closings under the new TRID requirements. Is that permissible?

A. The entire issue of using closed lists has been brought to the M&M answerperson service several times. The question raises two concerns. The first is what the effect is on tolerances of having a list from which the applicant must choice for any of the required services. The second, more specific, is whether it is permitted to restrict the choice of the title agent, insurer, or attorney.

We have heard lots of confusion about restricting the choice for a required service to a list of providers in hopes that the fees can be more readily tracked. The basic requirement to avoid the zero tolerance zone is to allow the applicant to shop for the service. Any restriction on that freedom to a list selected by the lender, immediately takes you to zero tolerance. If you permit shopping, you must provide a list, which may only be one provider in the relevant area for the service. If the applicant selects that suggested provider, the cost will be in the 10% tolerance grouping. If the applicant chooses some other provider, the tolerances will not apply. On the other hand, if you do not permit shopping, you are not required to provide any list at all, though you may if you wish to do so. That's where the closed list turns up. Providing the closed list allows the applicant to say whom they want the lender to choose from the list. It may feel more customer friendly to the applicant, but the lender is still controlling the choice, so zero tolerance applies to increases in cost.

The second issue here is about restricting the selection of the title services company or the attorney. State requirements differ on the extent to which the lender can dictate. The Maine requirement appears to be the most explicit, where the applicant must be provided a disclosure that they may select the attorney to complete the title, and must indicate whether or not they wish to select their own attorney or let the lender decide. So, in Maine a closed list of any sort is not permitted. In Massachusetts, while the lender can go ahead and select, a disclosure is required saying that the attorney is representing the lender, so the applicant may wish to hire separate counsel. So far as we know, the other New England states have no similar requirements. Other requirements are in place in Maine and Massachusetts regarding insurance (homeowners, title, and flood determination) and in Connecticut (mortgage insurance) which limit the extent to which lenders can restrict shopping. Lenders contemplating restrictions on providers of title work or insurance should proceed with caution.

Important Dates– Don't Forget!

(Generally we retain the prior month, and go forward for at least a year as known. Dates are either effective dates of final rules, or end of the comment period for proposed rules.)

07/24/2015 TRID Effective Date Delay. Final Rule in Federal Register delays TRID rules to October.
08/10/2015 Appraisal Management Companies. Regulations H & Y interagency fin al rule.
10/01/2015 Flood Insurance Regulations. Interagency final rule, effective in part.
10/01/2015 Military Lending Act Regulation. Effective date of revisions. Mandatory 10/01/2016.
10/03/2015 Integrated Disclosures (TRID). NEW effective date.
01/01/2016 Flood Insurance Regulations. Escrow rules effective.
01/01/2016 Regulation Z. Small Creditor, Rural and Underserved Areas revised
10/01/2017 Military Lending Act Regulation. Sections on credit card accounts become mandatory.