M&M CONSULTING | Partners in Risk Management

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Practical Compliance

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In This Issue

Military Lending Act – Unresolved Issues

This article is a follow-up to the one included in the April 2016 edition of *Practical Compliance* on the *Military Lending Act* (MLA), and the Final Rule for which compliance with most of its provisions become mandatory on October 3, 2016. It turns out that what initially appeared to be a fairly straightforward series of amendments is not so straightforward in certain areas from a practical compliance perspective.

This article provides an overview of a number of the key issues in the Final Rule in need of resolution, industry efforts seeking resolution of all such issues, and proposed solutions to the issues noted in this article that have been submitted to the Department of Defense (DoD) for consideration.

Key Issues

Oral Disclosures Using Toll-free Telephone Number Option

Section 232.6(d)(2) of the Act requires that in addition to providing written disclosures for the statement of the MAPR and the payment obligation description, these disclosures must also be provided orally.

These oral disclosures can be provided by the creditor to a covered borrower directly in person, or by providing a toll-free telephone number in order to deliver the oral disclosures to a covered borrower when the covered borrower contacts the creditor for this purpose. If the toll-free telephone number approach is selected, that number must be included either on the application or on the written Payment Obligation disclosure.

- ***MAPR:*** The Final Rule provides a model statement describing the MAPR which can be used for both written and oral disclosure purposes. The model disclosure is general versus loan specific. Thus providing the disclosure in writing and orally should not be problematic. The model statement reads as follows:

  Federal law provides important protections to members of the Armed Forces and their dependents relating to extensions of consumer credit. In general, the cost of consumer credit to a member of the Armed Forces and his or her dependent may not exceed an annual percentage rate of 36%. This rate must include, as applicable to the credit transaction or account: the costs associated with credit insurance premiums; fees for ancillary products sold in connection with the credit transaction; any application fee charged (other than certain application fees for specified credit transactions or accounts); and any participation fee charged (other than certain participation fees for a credit card account).

- ***Payment Obligation Description:*** Section 232.6(a)(3) of the Act requires that a clear description of the payment obligation of the covered borrower be provided, as applicable. For example, providing a payment schedule (in the case of closed-end credit) or an account opening disclosure (in the case of open-end credit) pursuant to Paragraph (a)(2) regarding applicable Regulation Z disclosures, satisfies this requirement.

If a creditor provides an oral payment obligation description in person to a covered borrower, compliance with this disclosure requirement should not be an issue. However, if a creditor elects to provide a toll-free number to provide an oral payment obligation description, it must be able to make the individualized payment terms of the borrower available orally. From a practical compliance perspective, such a system may be difficult, at best, for institutions to develop and implement.

Use of a Check or Other "Method of Access" to Make Payments

Section 232.8(e) provides that it is unlawful if a creditor "uses a check or other method of access to a deposit, savings, or other account maintained by the covered borrower," subject to certain exceptions. Read literally, could be interpreted as meaning that a covered borrower may not use a check or automatic ACH to pay their loan. The apparent intent of this prohibition is to target payday-like practices of ensuring payment by obtaining an advance check or recurring debit authorization from the consumer at the time of the loan, to be processed when the loan becomes due. However, this prohibition may have unintended consequences which adversely impact covered borrowers and creditors.

Savings / CD Secured Loans

Section 232.8(e)(3) provides that, if not otherwise prohibited by applicable law, a creditor may take a security interest in funds "deposited after the extension of credit" in an account. This provision will prevent covered borrowers from receiving secured credit cards and other loans secured by funds placed in a deposit account, such as a savings account or CD, before or at the time of an extension of credit, which can be an important source of credit for some consumers, including covered borrowers and can enable them to establish or improve their credit history. Thus, covered borrowers will not be eligible for such common types of loans.

Inclusion of Conditional Terms and Disclosures in Agreements

Section 232.9(c) contains broad language regarding the voiding of contracts that contain certain prohibited provisions. As a result, creditors will no longer be able to use a single agreement for all borrowers, even if the agreement includes:

- Provisions prohibited by part 232 (including arbitration) but affirmatively states that those provisions do not apply to covered borrowers;
- The MAPR statement, consistent with § 232.6(c)(2); and
- The Regulation Z disclosures, consistent with longstanding practice for certain products.

There is concern that the inclusion of a prohibited provision (even with an affirmative statement that it does not apply to covered borrowers) or an inadvertent erroneous disclosure may result in a court deeming a contract void under § 232.9(c).

Efforts to Address Unresolved Issues

Trade Association Efforts

In April 2016, the American Bankers Association, the American Financial Service Association, the Association of Military Banks of America, the Consumer Bankers Association, the Credit Union National Association, the Independent Community Bankers of America, the National Association of Federal Credit Unions, and the Financial Services Roundtable submitted a letter to the Department of Defense (DoD) containing Recommended Clarifications and Modifications to the Military Lending Act, urging the DoD to adopt on an interim basis and to propose for public comment "final interim" amendments to the regulation to promote transparency and consistency for covered borrowers, consumers, regulators, courts, and the lending

industry. The Trade Associations believe that providing guidance on the issues discussed in their letter will help ensure that military personnel and their spouses and dependents continue to have access to a wide range of credit products.

On June 23, 2016, the Trade Associations met with Diana Banks, the recently appointed deputy undersecretary of defense for personnel and readiness, as well as other DoD representatives, and others to discuss the ongoing compliance concerns. It was reported that the participants also discussed the need for an extension in the October compliance deadline given delays in rule clarification and database availability. It was also reported that the DoD is working on changes that would facilitate compliance, such as signing the necessary contracts to allow lenders to verify borrowers' military status through credit reports, as well as issuing an interpretive rule to address compliance concerns identified in the Trade Associations' April 2016 letter.

Proposed Solutions

With respect to the specific unresolved issues discussed in this article, the Trade Associations' April 2016 letter proposed the following solutions to the DoD for consideration:

- **Oral Disclosures Using Toll-free Telephone Number Option:** Permit creditors to comply by providing a model statement orally, similar to the model statement for the MAPR in § 232.6(c)(3) and consistent with the intent of § 987(c)(1)(C) of the statute that covered borrowers understand their payment obligations. Amend § 232.6(c) to add a new paragraph (4):

  (4) Model statement. A statement substantially similar to the following statement may be used for the purpose of paragraph (a)(3) and (d)(2) of this section: "Federal law requires that you receive a clear description of your required payments. Please review the disclosures and your credit agreement carefully to understand your payment obligations."

- **Use of a Check or Other "Method of Access" to Make Payments:** Amend § 232.8(e) by adding a new paragraph (4) to state:

  (4) This paragraph (e) does not prohibit a covered borrower from making a payment or a creditor from accepting a payment by use of a check or other method of access to a deposit, savings, or other account maintained by a covered borrower for an extension of consumer credit after the consumer has become obligated on a transaction or an account has been opened.

- **Savings / CD Secured Loans:** Amend § 232.8(e)(3) to state:

  (3) If not otherwise prohibited by applicable law, take a security interest in funds deposited after the extension of credit in an account established or maintained in connection with the consumer credit transaction.

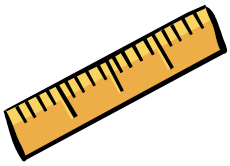
- **Inclusion of Conditional Terms and Disclosures in Agreements:** Amend § 232.9(c) to state:

  (c) Contract void. Any credit agreement, promissory note, or other contract with a covered borrower that fails to comply with 10 U.S.C. 987 as implemented by this part or which contains one or more provisions prohibited under 10 U.S.C. 987 as implemented by this part is void from the inception of the contract. However, a credit agreement, promissory note, or other contract is not void solely because it includes:

  (i) An otherwise prohibited provision that expressly excludes covered borrowers; or

  (ii) A disclosure required by § 232.6 that fails to conform with the applicable timing, content, or format requirements. This provision does not affect any other applicable remedies under this part.

Short Clips



CFPB Publishes Updated HMDA Resources

On July 20, 2016, the Consumer Finance Protection Bureau (CFPB) updated its website to include a page with updated Resources for HMDA Filers. The resources include filing instruction guides for HMDA data collected in 2017 and 2018; an overview of the web-based data submission platform; and a frequently asked questions (FAQ) document. Take note that beginning with data collected in 2017, filing will be done with the CFPB, not the Federal Reserve.

FinCEN Issues FAQ Guidance on CDD Rule

On July 19, 2016, the Financial Crime Enforcement Network (FinCEN) issued FAQ Guidance to provide greater clarity on the scope and application of financial institution obligations under the recent customer due diligence rule (and covered in the June edition of *Practical Compliance*). The rule requires financial institutions to collect information on beneficial owners *(e.g., individuals who owns more than 25 percent of the equity interests in a company, or who are the single individual who exercises control)* when an account is opened. Covered institutions have until May 11, 2018 to be compliant with the rule.

Agencies Release Final Revisions to Interagency Q&A Regarding CRA

On July 15, 2016, the Federal Financial Institutions Examination Council (FFIEC) announced that it had published final revisions to the Interagency Questions and Answers on the FFIEC CRA website.

The new and revised guidance addresses questions raised by bankers, community organizations, and others regarding the agencies' CRA regulations in the following areas:

- Availability and effectiveness of retail banking services.
- Innovative or flexible lending practices.
- Community development-related issues, including:
  - (i) economic development;
  - (ii) community development loans and activities that revitalize or stabilize underserved nonmetropolitan middle-income geographies; and
  - (iii) community development services.
- Responsiveness and innovativeness of an institution's loans, qualified investments, and community development services.

CFPB Proposed Amendment to the Annual Privacy Notice Requirement Under the Gramm–Leach–Bliley Act (Regulation P)

On July 1, 2016, the CFPB issued a proposed amendment to the Gramm-Leach-Bliley Act to conform its regulations on privacy notice requirements to last winter's legislation that provides banks meeting certain requirements an exemption from sending an annual privacy notice. To do so, the bureau is withdrawing its 2014 rulemaking providing an alternative delivery method for the notices.

In December 2015, Congress amended the GLBA as part of the Fixing America's Surface Transportation Act (FAST Act). This amendment provides financial institutions that meet certain conditions an exemption to the requirement under the GLBA to deliver an annual privacy notice. A financial institution can use the annual notice exception if it limits its sharing of customer information so that the customer does not have the right to opt out and has not changed its privacy notice from the one previously delivered to its customer. The CFPB proposal would implement this legislation, and would also establish deadlines for institutions resuming annual privacy notices if their practices change and cease to qualify for the exemption.

The proposed amendments to Reg. P appeared in the July 11, 2016 Federal Register, with comments due by August 10, 2016. The proposed amendments will be effective 30 days after any final rule is published in the Federal Register.

FDIC Updates FAQ on Identifying, Accepting and Reporting Brokered Deposits

On June 30, 2016 The FDIC issued FIL-42-2016, announcing updates to its Frequently Asked Questions (FAQs) regarding identifying, accepting

and reporting brokered deposits. In November 2015, the FDIC released for comment proposed updates to the FAQs that were originally issued in January 2015. The FDIC has retained a majority of the proposed updates, with certain clarifications, in addition to some new FAQs. This latest FIL supersedes FIL-2-2015 and FIL-51-2015.

FDIC Streamlines Information Technology Risk Examination (InTREx) Program

On June 30, 2016, the FDIC issued FIL-43-2016, announcing it had updated its Information Technology and Operations Risk (IT) Examination Procedures to provide a more efficient, risk-focused approach. The enhanced program also provides a cybersecurity preparedness assessment and discloses more detailed examination results using component ratings.

CFPB Updates 2017 Regulation Z Dollar Thresholds

On June 27, 2016, the CFPB issued a Final Rule regarding the 2017 changes in dollar thresholds (based on changes in the Consumer Price Index) for several Regulation Z provisions governed by the CARD Act, the Home Ownership and Equity Protection Act and the Dodd-Frank Act.

For credit cards, the penalty fees safe harbor for 2017 will remain at $27 for a first late payment. Due to a miscalculation from the previous adjustment, the bureau has recalculated the subsequent late payment safe harbor fee to be $38, effective immediately. This new figure will remain unchanged in 2017. The minimum interest charge disclosure threshold will also remain unchanged for 2017. The HOEPA loan threshold will increase slightly to $20,579 and the HOEPA fee trigger will be $1,029, effective Jan. 1.

For Qualified Mortgages, points and fees cannot exceed 3 percent of loans of $102,894 or more; $3,087 for loans between $61,737 and $102,894; 5 percent for loans between $12,862 and $20,579; and 8 percent for loans of less than $12,862.

CFPB Releases Special Edition of Supervision Highlights and Updates Mortgage Servicing Exam Procedures

On June 22, 2016, the CFPB released a special edition supervision report focused specifically on mortgage servicers. The report found that some mortgage servicers continue to use failed technology that has already harmed consumers, putting the company in violation of the CFPB's new servicing rules which took effect in January 2014. In its examinations of numerous mortgage servicers, CFPB examiners have found violations due to deficient technology and process breakdowns. Specifically, examiners have observed problems with loss mitigation and servicing transfers. To spur industry compliance with CFPB servicing rules, the Bureau also released its updated mortgage servicing exam manual.

FFIEC Adds 2016 Distressed or Underserved Geographies List to CRA Website

On June 17, 2016, the FFIEC announced that the 2016 Distressed or Underserved Nonmetropolitan Middle-Income Geographies List had been added to its CRA website.

CFPB Unveils New "Know Before You Owe" Auto Loan Shopping Sheet

On June 9, 2016, the CFPB unveiled a new "auto loan shopping sheet", a step-by-step guide, and additional online resources as part of a new "Know Before You Owe" initiative aimed at helping consumers shop for an auto loan. The shopping sheet helps consumers see the total cost of a loan and make apples-to-apples comparisons among loan products. The "Know Before You Owe" auto loan initiative also walks consumers through each step of the auto finance process to help them decide how much they can afford to borrow and what options are right for them.

CFPB Adds Three Regulations to its Online eRegulations Tool

On June 6, 2016, the CFPB added three regulations to its web-based eRegulations tool; the Real Estate Settlement Procedures Act (Regulation X), the Home Mortgage Disclosure Act (Regulation C) and the Truth in Savings Act (Regulation DD). In addition, the CFPB updated a section of the existing Truth in Lending Act (Regulation Z) eRegulation to reflect recent changes.

Good to Know

Send your questions to the
answerperson@mandm.consulting

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

Q: We have a customer whose flood insurance coverage is 250K as part of a $14 million Zone X Residential Condo Building Association Policy for a 57-unit building. A remapping was recently performed, and the flood zone is now rated AE. (The flood insurance payments for Zone X are part of the condo fees.)

According to the Insurance agent, they will not change the policy from Zone X to Zone AE until the policy renews, so that they are able to grandfather the Zone X coverage. We have force placed the flood insurance. However, we have not yet charged the homeowner. We are not sure what amount to charge the customer. They already pay for Zone X. We believe we have the right to charge the customer the difference between Zone X and Zone AE. Please advise.

A: You have an interesting scenario there. It sounds like the dollar amount of flood insurance coverage provided through the condo association is sufficient for your loan to this borrower, rather it's the depth of coverage *(pardon the pun)* that's the issue. From what you've described, the Bank will absorb a portion of the cost of the force-placed coverage, and only charge the borrower the difference in the current per-unit cost for flood insurance paid as part of condo fee and the cost of the force-placed "unit-owner" policy coverage written at the appropriate risk rating.

If my understanding of these matters is correct, your approach appears to be logical, fair, and relatively short term until the Association renews its master flood insurance policy. I can't see where a regulator or the borrower could take issue with it. The Bank should not have to absorb the total cost of the force placed policy, and I can't think of any better / fairer way to determine the split of the premium.

Q: Are financial institutions required to report credit information to all three major credit reporting agencies (TransUnion, Equifax and Experian)? Would there be any issues if we decided to report to only two of the three? TransUnion has decided to now charge for reporting credit information to them, which is what prompted the question. What do you think?

A: Based on my research, creditors are not required to report credit information to all three major credit reporting agencies. As such, I'm not aware of any specific issues (aside from possible questions raised by customers regarding the practice). However, this is ultimately a Management decision that should be based on the costs, benefits, and assessment of any additional risks associated with such a change.

Q: We are not a HMDA reportable institution, thank goodness! However, we gather and monitor the data the same way we would if we were. I am wondering how we handle Type of Purchaser in the scenario where we originate the loan and post-closing we identify the loan as a loan we wish to sell? Code 0 says it was not sold within the calendar year. At this point we sell loans a month or two after they are originated but by the loan has already been reviewed for HMDA. What is the best practice for this situation?

A: You've raised an issue that slips through the cracks even for some HMDA reporting institutions; loans sold some time after they are originated. HMDA requires reporting institutions to ensure their LAR is updated at least on a quarterly basis, which would include a review and update of purchaser code information for all originated loans on the LAR. In my opinion, if you take that approach, you should be all set. If you were a HMDA reporter, I'd add that you should do one last check prior in addition to a final check prior to submitting the LAR for sales that occurred prior to year-end but which may not have been recorded at the time of the prior check.

Q: When we integrated over to our new Loan Origination System (LOS), we stopped using paper applications. The lender inputs all the data into the LOS, and then prints out the application for them to sign.

My question is, during a face-to-face application, the lender asks about the GMI and the customer doesn't want to provide the information, how

should we complete this? If this was a paper app and the customer checked off the box that says "I do not wish to furnish this information", the lender still has to complete it based on visual observation. Should we follow the same thought process by checking the "I do not wish to furnish this information" and also checking the applicable GMI boxes to demonstrate that the information marked was based on visual observation and not what the customer stated?

My other question is in regards to web applications. Our website app only asks for basic information and does not ask for GMI.

A: With respect to your first question, the approach you've described seems most appropriate; as it documents that you had a face to face application, that the borrower did not wish to provide the GMI information, and that the GMI information noted was provided by the loan officer. I would suggest that you formally document this methodology, as appropriate, in your written procedures. That way, you have something to show the regulators regarding this methodology should questions arise, and you can nip them in the bud.

As for your second question, if the web app does not ask for GMI, and you are required under Regulation B or C to obtain it; then yes, you must request the GMI, making the disclosures regarding the request required under §1002.13(c) of Reg. B.

Q: We are in the process of preparing the initial CD for a loan. We just found a note in the file that, back at the beginning of July, the borrower requested a "mail away" closing. The lender failed to notify us of this, and therefore we missed the opportunity to provide a revised LE with the "mail away" fee to reset our tolerance. The "mail away" fee is charged by the settlement agent, who was selected by us, so it is a zero tolerance item.

We are disclosing the "mail away" fee on the initial CD. My interpretation of the regulation is that we have to cure this, and that we are not able to simply add the fee to the initial CD and have the borrower pay the fee. Is my interpretation correct?

A: Since this fee is a zero tolerance item, the Bank has to cure that tolerance by paying the fee for this service itself. It cannot simply add the fee to the initial CD and have the borrower pay it. The fee should be listed on Page 2 of the CD in the "Paid by Others" column with the letter "L" in parentheses to the left of the amount.

Q: We have an executive officer under Regulation O, who prior to being designated an executive officer was granted a $150,000 first-lien Home Equity line of credit. The purpose of the HELOC was neither to improve the home nor to fund a child's education.

As this individual is now an executive officer under Regulation O, does the Bank need to modify the HELOC Agreement to include a "payable on demand" clause, and also reduce the maximum line amount to 100,000 to comply with the requirements for another purpose other than those allowed under with the other purpose provisions provided under the regulation?

A: Since that individual obtained the HELOC before obtaining the executive officer position, it is not, in my opinion, subject to the particular provisions of Regulation O you've raised. However, if the Bank renews or extends the line, then you would need to reduce the maximum amount of the line to $100,000 to comply with the "other purpose" credit provision outlined in §215.5(c)(4), and add a provision that the line is payable on demand to comply with §215.5(d)(4).

Q: We provide loan applicants with a list of service providers we use on a regular basis. We have never disclosed fees on this list. We are in the process of setting up and training on a new LOS. The folks helping us set up our documents are advising that the fees for each service provider should be disclosed on the list. Is this true; must the various fees be disclosed for each and every service provider we use?

A: Neither §1026.19(e)(1)(vi)(C) nor its related Commentary contain any specific requirements to disclose fees on the List of Service Providers. However, Model Form H-27(A), *Written List of Providers,* does provide a column for estimated costs, which is most likely the basis for the consultants' recommendation, even though not technically required.

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.)

07/01/2016 Education Dept., Campus Bank Accts. Final rule. Impacts institution and student bank accts.
07/29/2016 FinCEN, FBME Bank, Ltd. Special Measures. Effective date of special measures final rule.
08/01/2016 FDIC, Annual Adjustment of Maximum CMPs. Effective date of Interim Final Rule.
08/10/2016 Appraisal Mgmt. Cos. Interagency final rule for AMC registration and supervision mandatory.
08/10/2016 CFPB, Reg. P, Proposed Rule. Comment period ends. Conforming regulation to legislation.
09/23/2016 Federal Reserve, Same-Day ACH Service and Schedule. Effective date ACH enhancements.
10/01/2016 Military Lending Act Regulation. Expanded "consumer credit" account coverage mandatory.
10/01/2017 Military Lending Act Regulation. Sections on credit card accounts become mandatory.
01/01/2017 CFPB, Reg. Z Adjusted Dollar Thresholds for Certain Credit Transactions. Effective date.
01/01/2017 NCUA, Final Member-Business Lending Rule. Provides CUs greater business lending flexibility.
01/01/2017 HMDA, Regulation C. Low volume institutions further excluded from coverage.
01/01/2018 HMDA, Regulation C. Revised transaction coverage and expanded fields effective.
01/01/2020 HMDA, Regulation C. Quarterly reporting for high volume reporters starts.

More Important Dates… 2016 M&M Compliance School

Just a "Last Call" reminder that the 2016 *M&M Compliance School* will be held September 13, 14 & 15, 2016 (Tuesday - Thursday) at the *Doubletree by Hilton* in Milford, Massachusetts (Exit 19 off I-495). The cost for this year's program for clients is $375 for all 3 days! If you haven't done so already, please contact Jay Friedland (jaybanker@mandm.consulting or (207)-650-4665) for more information!

