WISCONSIN BANKERS ASSOCIATION
Compliance Journal

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Read "Special Focus" for an article on Wisconsin's lending limits applicable to derivatives. Next, check "Regulatory Spotlight" for numerous mortgage reform final rules. Finally, turn to "Compliance Notes" for items on the backup withholding rate for 2013, and a new federal law which eliminates the requirement to post a placard on ATMs regarding fees.■

SPECIAL FOCUS

Dodd-Frank Requires DFI Interpretation of Wisconsin Bank Lending Limit Laws Applicable to Derivatives

Notice No. 2013-1

Effective **January 21, 2013**, Section 611 of the Dodd-Frank Act (DFA) permits an insured state bank to engage in a derivative transaction **only if** the law with respect to lending limits of the state in which the state bank is chartered takes into consideration the bank's credit exposures in derivative transactions. Without any further action on the part of the state, state banks in Wisconsin would likely be prohibited from engaging in derivative transactions beginning January 21, 2013.

In response to this DFA requirement, DFI Division of Banking issued Banking Letter #49 dated January 11, 2013, to all state banks chartered in Wisconsin. DFI Division of Banking determined in Banking Letter #49 that Wisconsin's lending limit statutes, sections 214.54 for state savings banks and 221.0320 for state commercial banks, are broad enough to include derivative transactions, subject to the state's lending limit laws. According to Banking Letter #49, "the potential future credit exposure arising from a derivative transaction shall be determined for legal lending purposes." As a result of Banking Letter #49, beginning on January 21, 2013, state savings banks and state commercial banks are required to apply the state's lending limit laws to the bank's credit exposures in derivative transactions.

Section 610 of DFA imposes similar requirements on national banks. The OCC has issued a proposed interpretation to require that loans and extensions of credit by national banks include credit exposures arising from derivative transactions, repurchase agreements, reverse repurchase agreements, securities lending transactions and securities borrowing transactions. The OCC has deferred the effective date of its interpretation for national banks to July 1, 2013. State banks, however, must comply with the requirements under Section 611 of DFA and Banking Letter #49 beginning January 21, 2013.

Banking Letter #49 defines a "derivative transaction" to include "any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices or other assets." As bankers are aware, derivatives are often used as risk-shifting devices. For example, to mitigate risk that occurs from ordinary lending transactions, banks typically use derivatives known as "interest rate swaps" which are an exchange of interest payments on a specified amount. In a low interest rate environment, borrowers may desire fixed rate loans. Banks, however, may prefer making floating rate loans to better match the inevitable changes in interest rates they pay for deposits and wholesale borrowings that serve as the funding source for customer loans. To allow the borrower to pay a fixed rate, the bank may enter into an interest rate swap with a counterparty and swap its fixed rate loan payment stream for a floating rate payment stream based on an identical principal amount, as a hedge to better control fluctuations in its borrowing costs.

Banking Letter #49 requires state banks beginning January 21, 2013, to make determinations at the inception of the transaction of the potential credit exposure from the derivative transaction in a manner similar to that to be required for national banks. Banking Letter #49 states that beginning January 21, 2013, the Division of Banking will consider the credit exposure of derivative transactions when computing lending limits under Wisconsin law. The Division of Banking has confirmed in writing that Banking Letter #49 will apply only to new derivative transactions entered into on or after January 21, 2013, and not to derivative transactions already on the books of state banks.

The potential future credit exposure for a state bank arising from a derivative transaction is to be determined for legal lending limit purposes and calculated using a method called the Remaining Maturity Method specified in Banking Letter #49. The credit exposure for a state bank arising from a derivative transaction under the Remaining Maturity Method shall equal the greater of zero or the sum of the

current mark-to-market value of the derivative transaction added to the product of (1) the notional amount of the transaction, (2) the remaining maturity in years of the transaction, and (3) a fixed multiplicative factor determined by reference to Table 1 set forth in Banking Letter #49. An example based on the Remaining Maturity Method is described in the following paragraph.

With respect to derivatives, the mark-to-market value of a derivative transaction in the beginning is typically zero, but will change over time as the asset or index on which the contract is based fluctuates in value. The Remaining Maturity Method is intended to measure the credit exposure for a bank from time to time during the term of the derivative transaction. For example, if the bank enters into a 5 year swap for a notional amount of $10 million and after 3 years of the term of the transaction the current mark-to-market value of the derivative transaction is $250,000 (the bank is owed this amount by the counterparty and therefore at risk should the counterparty fail), the future credit exposure for the bank would be $550,000. This calculation after 3 years of the term would be made as follows based on the formula described in the preceding paragraph and as set forth in Banking Letter #49: $250,000 (current market value after 3 years of the derivative transaction) plus ($10 million (notional amount) times 2 (remaining maturity of two years on the transaction) times 0.015 (the multiplicative factor set forth in Table 1 of Banking Letter #49)), which would equal $550,000 in this example (the future credit exposure of the bank).

Notably, Banking Letter #49 does not address the situation where a state bank, subsequent to entering into a derivative transaction, exceeds the legal lending limit as a result of an increase in the mark-to-market value of the derivative transaction with the counterparty. We have asked DFI Division of Banking how it intends to handle such a situation and will inform WBA members of the DFI Division of Banking interpretation as soon as we receive it. Certainly, at a minimum, the bank should not enter into any additional derivative transactions or other credit transactions with that counterparty at any time the credit exposure in those transactions exceed in the aggregate the bank's legal lending limit.

We also asked DFI Division of Banking whether a state bank could off-set its credit exposure for a derivative transaction by pledged collateral. DFI responded by stating that the only exception from the state commercial bank lending limit under section 221.0320 for collateral is for a liability that is secured by not less than a like amount of direct obligations of the United States which will mature not more than 18 months after the date the liability to the bank was entered into. Otherwise, there is no reduction of the lending limit calculation based on pledged collateral under section 221.0320 for state banks. Note, however, that the legal lending limit for state savings banks under section 214.54 may in some cases vary if secured by certain types of collateral.

Banking Letter #49 and the approach it takes to interpreting Wisconsin law should permit DFI Division of Banking to address issues as they arise from time to time by a change to its interpretation rather than seek a legislative change to the statute each time an issue needs to be addressed. This is a complicated subject and further modifications to Banking Letter #49 should be expected, particularly given that the OCC has not yet finalized its interpretive guidance applicable to national banks regarding the comparable Section 610 of DFA.■

WBA wishes to thank Atty. John Knight, Partner, Boardman and Clark llp, for providing this article.

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WISCONSIN BANKERS ASSOCIATION
Compliance Journal

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Read "Special Focus" for an article on amendments to the COPPA Rules. Next, check "Regulatory Spotlight" for numerous CFPB mortgage lending rules. Finally, turn to "Compliance Notes" for a CFPB bulletin regarding mortgage loan transfers between servicers.■

SPECIAL FOCUS

Recent Amendments to Children's Online Privacy Protection Rules

Notice No. 2013-2

Introduction

When Congress passed the Children's Online Privacy Protection Act of 1998 (COPPA), it mandated that the Federal Trade Commission (FTC) write implementing rules. These rules are often referred to as the "COPPA Rules". The COPPA Rules apply to operators of websites or online services that are either directed to children under 13 or have actual knowledge that they are collecting "personal information" from children under 13. The COPPA Rules require operators to give detailed notice to parents and get their verifiable consent before collecting, using, or disclosing such personal information. The information they collect from children must be kept secure. The COPPA Rules also prohibit operators from conditioning children's participation in activities on the collection of more personal information than is reasonably necessary for them to participate. In addition, it also contains a "safe harbor" provision that allows industry groups or others to seek FTC approval of self-regulatory guidelines.

FTC recently issued a final rule which amends the COPPA Rules. The purpose of the final rule is to further strengthen privacy protections for children under 13 and give parents greater control over the personal information that websites and online services may collect from their children. The final rule was needed to stay current with changes in technology and changes in the way children use and access the Internet, including the increased use of social media and mobile devices like smart phones. Although promulgated by FTC, the COPPA Rules certainly may apply to financial institutions. And given that institutions are utilizing the Internet and various forms of social media with increasing frequency, it is important to be aware of the amendments to the COPPA Rules. The following is meant to provide a brief overview of certain key amendments to the COPPA Rules, and does not cover every aspect of the COPPA Rules.

Definitions

The final rule amended the definition of "operator" to make it clear that the rule covers a child-directed site or service that integrates outside services, such as plug-ins or advertising networks, that collect personal information from its visitors. This definition does not extend liability to platforms, such as Google Play or the App Store, when such platforms merely offer the public access to child-directed apps.

The definition of "website or online service directed to children" was also amended to include plug-ins or advertising networks that have actual knowledge that they are collecting personal information through a child-directed website or online service. In addition, in contrast to sites and services whose primary target audience is children, and who must presume all users are children, sites and services that target children only as a secondary audience or to a lesser degree may differentiate among users, and will be required to provide notice and obtain parental consent only for those users who identify themselves as being younger than 13.

In addition, the definition of "personal information" was modified to include geolocation information, as well as photos, videos, and audio files that contain a child's image or voice, and "persistent identifiers". A "persistent identifier" is some type of information that can be used to recognize users over time and across different websites or online services. Examples of these identifiers include, but are not limited to, a customer number held in a cookie, an IP address, a processor or device serial number, or a unique identifier. While the collection of a personal identifier is generally subject to parental notice and verifiable parental consent requirements, such requirements do not apply when an operator collects a persistent identifier for the sole

purpose of supporting the website or online service's internal operations, such as contextual advertising, frequency capping, legal compliance, site analysis, and network communications. Without parental consent, such information may never be used or disclosed to contact a specific individual, including through behavioral advertising, to amass a profile on a specific individual, or for any other purpose.

The final rule also amended the definition of "support for internal operations" to clarify that it does not include the collection of persistent identifiers used to track children over time and across site or services, or to amass a profile on an individual child user based on the collection of identifiers over time and across different websites in order to make decisions or draw insights about the child. In addition, the final rule now includes a process by which industry may seek formal approval of new activities to be added to this definition.

Finally, the definition of "collection" of personal information has been modified so that operators may allow children to participate in interactive communities without parental consent, so long as the operators take reasonable measures to delete all or virtually all children's personal information before it is made public.

Parental Notice

The final rule streamlines and revises the parental notice provisions to help ensure that operators' privacy policies, and the direct and online notices they must give parents before collecting children's personal information, are concise and timely.

With regard to direct notices, the final rule provides for a more effective "just in time" notice to parents about the operator's information practices. Thus, in each of the various instances in which a direct notice is required, the final rule specifies the notice must contain: (1) certain information that operators must provide to parents regarding the items of personal information the operator has already obtained from the child (generally, the parent's online contact information either alone or together with the child's online contact information); (2) the purpose of the notice; (3) the action that the parent must take; and (4) what use, if any, the operator will make of the personal information collected. In addition, each direct notice must include a link to the operator's online notice of information practices.

With respect to the online notice requirement, the final rule removed the requirement to recite the operator's information, collection, and disclosure practices, in favor of a simple statement providing the following: (1) what information the operator collects from children, including whether the website or online service enables a child to make personal information publicly available; (2) how the operator uses such information; and (3) the operator's disclosure practices for such information.

Parental Consent Methods

The COPPA Rules require that to obtain verifiable parental consent, operators must do so by making reasonable efforts to obtain such consent, taking into account technology. In addition, any method of obtaining verifiable parental consent must be reasonably calculated in light of available technology to ensure the person providing consent is the parent's child. The final rule adds new methods to the existing non-exclusive list of methods that operators can use to obtain verifiable parental consent. These new methods include: (1) electronic scans of signed parental consent forms; (2) video-conferencing; (3) use of government-issued identification; and (4) alternative payment systems, such as debit cards and electronic payment systems, provided they meet certain criteria.

FTC also notes that the final rule retains the "sliding-scale mechanism of parental consent," otherwise known as "email plus," as an acceptable consent method for operators that collect personal information only for internal use. Under this method, operators that collect children's personal information for internal use only may obtain verifiable parental consent with an e-mail from the parent, as long as the operator confirms consent by sending a delayed email confirmation to the parent, or calling or sending a letter to the parent.

In addition, FTC indicates that to encourage the development of new consent methods, the final rule establishes a voluntary 120-day notice and comment process so parties can seek approval of a particular consent method.

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Operators participating in an FTC-approved safe-harbor program may use any consent method approved by the program.

Confidentiality and Security Requirements

The final rule also addresses confidentiality and security requirements. It requires operators to take reasonable measures to make sure that children's personal information is released only to service providers and third parties that are capable of maintaining the confidentiality, security, and integrity of such information, and who assure that they will maintain the information in such a manner. It also requires operators to retain children's personal information only as long as is reasonably necessary to fulfill the purpose for which the information was collected, and to take reasonable measures to protect against unauthorized access to, or use of, the information in connection with its deletion.

Safe Harbors

The COPPA Rules provide that operators who comply with an approved safe harbor program are deemed to be in compliance with COPPA. The final rule strengthens FTC's oversight of approved self-regulatory safe harbor programs by requiring the programs to audit their members and report annually to FTC the aggregated results of those audits.

Conclusion

The COPPA Rules can certainly apply to financial institutions. As technological change and innovation continues to evolve and use of technology increases by persons of all ages, including children under age 13, financial institutions must remain vigilant in understanding how this impacts their information collection, use and disclosure practices and procedures with respect to children. This should include a thorough review of COPPA Rules, as amended by the final rule, and the re-evaluation of such practices and procedures in light of this review. The final rule is effective **07/01/2013**, and the entire COPPA Rule, as amended by the final rule, may be found at: http://www.gpo.gov/fdsys/pkg/FR-2013-01-17/pdf/2012-31341.pdf. *Federal Register*, Vol. 78, No. 12, 01/17/2013, 3972-4014.■

REGULATORY SPOTLIGHT

Agencies Issue Final Rule on Appraisals for Higher-Priced Mortgage Loans.

The Board of Governors of the Federal Reserve System (FRB), Bureau of Consumer Financial Protection (CFPB), Federal Deposit Insurance Corporation (FDIC), Federal Housing Finance Agency (FHFA), National Credit Union Administration (NCUA), and Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) have issued a final rule to amend Regulation Z, which implements the Truth in Lending Act (TILA), and the official interpretation to the regulation. The revisions to Regulation Z implement a new provision requiring appraisals for "higher-risk mortgages" that were added to TILA by the Dodd-Frank Act. For mortgages with an annual percentage rate that exceeds the average prime offer rate by a specified percentage, the final rule requires creditors to obtain an appraisal or appraisals meeting certain specified standards, provide applicants with a notification regarding the use of the appraisals, and give applicants a copy of the written appraisals used. The final rule is effective **01/18/2014**. Copies of the final rule may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-02-13/pdf/2013-01809.pdf. *Federal Register*, Vol. 78, No. 30, 02/13/2013, 10367-10447.

Agencies Seek Comment on Interagency Appraisal Complaint Form Information Collection.

The Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC) and National Credit Union Administration (NCUA) (collectively the Agencies) are soliciting comments concerning their information collection titled, "Interagency Appraisal Complaint Form." The Agencies developed the Interagency Appraisal Complaint Form for use by those who wish to file a formal, written complaint that an entity subject to the jurisdiction of one or more Agencies has failed to comply with the appraisal independence standards or USPAP. The Interagency Appraisal Complaint Form is designed to collect information necessary for one or more Agencies to take further action on a complaint from an appraiser, other individual, financial institution, or other entities. Each appropriate Agency will use the information to take further action on the complaint to the extent it relates to an issue within its jurisdiction. Comments are due **02/28/2013**. Copies of the notice may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-01-29/pdf/2013-01765.pdf. *Federal Register*, Vol. 78, No. 19, 01/29/2013, 6174-6176.

WISCONSIN BANKERS ASSOCIATION
Compliance Journal

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Please read the inserted letter from WBA regarding an exciting, upcoming change for *WBA Compliance Journal*. Next, turn to "Special Focus" for an article concerning unfair, deceptive and now abusive, acts or practices. Check "Regulatory Spotlight" for an item regarding CFPB's preliminary list of rural and underserved counties, which will have bearing on several DFA mortgage reform regulations. Finally, read "Compliance Notes" for an IRS memorandum on the treatment of OREO carrying costs.■

SPECIAL FOCUS

Unfair, Deceptive or Abusive Acts or Practices

Notice No. 2013-3

Introduction

The topic of unfair, deceptive acts or practices (UDAP) has become an increasing concern for financial institutions of all sizes. This is particularly true given that, along with the existing UDAP standard under the Federal Trade Commission Act (FTC Act), institutions now face a new standard of unfair, deceptive or abusive acts or practices (UDAAP) under the Dodd-Frank Act (DFA).

UDAP and UDAAP are similar in terms of the unfair and deceptive acts or practices standards; however, they are not identical. The most obvious difference is the addition of the new "abusive" standard due to the passage of DFA. This article, the first of what may become a series of articles, briefly outlines the factors which regulators consider when determining whether an act or practice is unfair or deceptive. Much of the information provided within this article originates from the March 2004 joint statement on UDAP referenced below. The article will also touch on the uncertainty created by DFA with the introduction of the new "abusive" standard.

Background

In March 2002, the Office of the Comptroller of the Currency (OCC) issued an advisory letter to inform national banks and their operating subsidiaries about what may constitute unfair or deceptive acts or practices under Section 5 of the FTC Act. Then, in March 2004, the Board of Governors of the Federal Reserve System (FRB) and the Federal Deposit Insurance Corporation (FDIC) issued a joint statement to outline the standards for state-chartered institutions consistent with the 2002 standards adopted by OCC. The standards are to be used to determine when specific acts or practices by financial institutions are unfair or deceptive.

Section 5(a) of the FTC Act prohibits "unfair or deceptive acts or practices in or affecting commerce," and applies to all persons (including banks) engaged in commerce. OCC, FRB and FDIC have all affirmed their enforcement authority to take appropriate action when unfair or deceptive acts or practices are discovered.

In 2010, DFA was signed into law. Sections 1031 and 1036 of DFA (1) created a new standard—unfair, deceptive or abusive acts or practices and (2) provided rule writing authority to the Bureau of Consumer Financial Protection (CFPB) to interpret the new standard. The new standard is applicable to any person that engages in offering or providing a consumer financial product or service and any service provider.

Standard for Determining What is Unfair or Deceptive

As mentioned above, the FTC Act prohibits unfair or deceptive acts or practices. An act or practice may be found to be *unfair* where it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." A representation, omission, or practice is *deceptive* if it is likely to mislead a consumer acting reasonably under the circumstances and is likely to affect a consumer's conduct or decision regarding a product or service.

The standards for unfairness and deception are independent of each other. While a specific act or practice may be both unfair and deceptive, an act or practice is prohibited by the FTC Act if it is *either* unfair *or* deceptive. Whether an act or practice is unfair or deceptive will in each instance depend upon a careful analysis of the facts and circumstances. In analyzing a particular act or practice, regulators will be

guided by the body of law and official interpretations for defining unfair or deceptive acts or practices developed by the Courts and the Federal Trade Commission (FTC). Regulators will also consider factually similar cases brought by FTC and other agencies to ensure that these standards are applied consistently.

The standards, actions and practices outlined below apply to all products and services at every stage and to any activity. For example, they apply from a product's development and launch, to its advertising and marketing campaigns, to disclosures, contracts, account billings and/or statements, to any type of servicing, mitigation and collection activities, and to any type of third-party service providers assisting with maintenance and management of the product.

Unfair Acts or Practices

Assessing whether an act or practice is unfair

An act or practice is unfair whether it: (1) causes or is likely to cause substantial injury to consumers; (2) cannot be reasonably avoided by consumers; and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair. Each of these elements is discussed further below.

- *The act or practice must cause or be likely to cause substantial injury to consumers.*

To be unfair, an act or practice must cause or be likely to cause substantial injury to consumers. Substantial injury usually involves monetary harm. An act or practice that causes a small amount of harm to a large number of people may be deemed to cause substantial injury. An injury may be substantial if it raises a significant risk of concrete harm. Trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and more subjective types of harm will not ordinarily make a practice unfair.

- *Consumers must not reasonably be able to avoid the injury.*

A practice is not considered unfair if consumers may reasonably avoid injury. Consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions. Withholding material price information until after the consumer has committed to purchase the product or service would be an example of preventing a consumer from making an informed decision. A practice may also be unfair where consumers are subject to undue influence or are coerced into purchasing unwanted products or services.

- *The injury must not be outweighed by countervailing benefits to consumers or to competition.*

To be unfair, the act or practice must be injurious in its net effects—that is, the injury must not be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice. Offsetting benefits may include lower prices or a wider availability of products and services.

Costs that would be incurred for remedies or measures to prevent the injury are also taken into account in determining whether an act or practice is unfair. These costs may include the costs to the bank in taking preventative measures and the costs to society as a whole of any increased burden and similar matters.

- *Public policy may be considered.*

Public policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair.

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Deceptive Acts and Practices

Assessing whether an act or practice is deceptive

A three-part test is used to determine whether a representation, omission, or practice is "deceptive." First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Lastly, the misleading representation, omission, or practice must be material. Each of these elements is discussed below in greater detail.

- *There must be a representation, omission, or practice that misleads or is likely to mislead the consumer.*

An act or practice may be found to be deceptive if there is a representation, omission, or practice that misleads or is likely to mislead the consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be found to be deceptive if it is likely to mislead consumers. A representation may be in the form of express or implied claims or promises and may be written or oral. Omission of information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled.

In determining whether an individual statement, representation, or omission is misleading, the statement, representation, or omission will not be evaluated in isolation. The regulators will evaluate it in the context of the entire advertisement, transaction, or course of dealing to determine whether it constitutes deception. Acts or practices that have the potential to be deceptive include: (1) making misleading cost or price claims; (2) using bait-and-switch techniques; (3) offering to provide a product or service that is not in fact available; (4) omitting material limitations or conditions from an offer; (5) selling a product unfit for the purposes for which it is sold; and (6) failing to provide promised services.

- *The act or practice must be considered from the perspective of the reasonable consumer.*

In determining whether an act or practice is misleading, the consumer's interpretation of or reaction to the representation, omission, or practice must be reasonable under the circumstances. The test is whether the consumer's expectations or interpretations are reasonable in light of the claims made. When representations or marketing practices are targeted to a specific audience, such as the elderly or the financially unsophisticated, the standard is based upon the effects of the act or practice on a reasonable member of that group.

If a representation conveys two or more meanings to reasonable consumers and one meaning is misleading, the representation may be deceptive. Moreover, a consumer's interpretation or reaction may indicate that an act or practice is deceptive under the circumstances, even if the consumer's interpretation is not shared by a majority of the consumers in the relevant class, so long as a significant minority of such consumers is misled.

In evaluating whether a representation, omission or practice is deceptive, regulators will look at the entire advertisement, transaction, or course of dealing to determine how a reasonable consumer would respond. Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text or is counseled that reading the disclosure is unnecessary. Likewise, oral disclosures or fine print may be insufficient to cure a misleading headline or prominent written representation.

- *The representation, omission, or practice must be material.*

A representation, omission or practice is material if it is likely to affect a consumer's decision regarding a product or service. In general, information about costs, benefits, or restrictions on the use or availability of a product or service is material. When express claims are made with respect to a financial product or service, the claims will be presumed to be material. Similarly, the materiality of an implied claim will be presumed when it is demonstrated that the institution intended that the consumer draw certain conclusions based upon the claim.

Claims made with the knowledge that they are false will also be presumed to be material. Omissions will be presumed to be material when the financial institution knew or should have known that the consumer needed the omitted information to evaluate the product or service.

"Abusive" Under Dodd-Frank Act

As mentioned above, DFA created two new sections of law which has resulted in a new "abusive" standard and gives CFPB the power to declare that an act or practice is abusive if it:

- Materially *interferes with the ability of a consumer to understand* a term or condition of a consumer financial product or service; or

- *Takes unreasonable advantage* of:

  - A *lack of understanding* on the part of the consumer of the material risks, costs, or conditions of the product or service;

- The *inability of the consumer to protect the interests of the consumer* in selecting or using a consumer financial product or service; or

- The *reasonable reliance by the consumer on a covered person to act in the interests of the consumer*.

Unfortunately, with the creation of this new standard, there is uncertainty of how regulators will interpret and regulate the new standard. As DFA gives CFPB rule writing authority to interpret the new standard, WBA believes the other prudential regulators are unwilling to provide even informal guidance to institutions on what may constitute an abusive act or practice. Having said that, the DFA provision is effective now even absent an implementing regulation. For that reason, financial institutions must be mindful of this new standard and may need to consult with their legal counsel about matters that could potentially be unfair, deceptive or abusive acts or practices.

Relationship to Other Laws

Acts or practices that are unfair or deceptive within the meaning of section 5 of the FTC Act (or the additional DFA abusive standard) may also violate other federal or state statutes. On the other hand, there may be circumstances in which an act or practice violates section 5 of the FTC Act even though the institution is in technical compliance with other applicable laws, such as consumer protection and fair lending laws. Financial institutions should be mindful of both possibilities. The following laws warrant particular attention in this regard:

- *Truth in Lending and Truth in Savings Acts*

Pursuant to the Truth in Lending Act (TILA), creditors must "clearly and conspicuously" disclose the costs and terms of credit. The Truth in Savings Act (TISA) requires depository institutions to provide interest and fee disclosures for deposit accounts so that consumers may compare deposit products. TISA also provides that advertisements shall not be misleading or inaccurate, and cannot misrepresent an institution's deposit contract. An act or practice that does not comply with these provisions of TILA or TISA may also violate the FTC Act, and potentially the new DFA abusive standard. On the other hand, a transaction that is in technical compliance with TILA or TISA may nevertheless violate the FTC Act and new abusive standard. For example, consumers could be mislead by advertisements of "guaranteed" or "lifetime" interest rates when the depository institution intends to change the rates, whether or not the disclosures satisfy the technical requirements of TILA or TISA.

- *Equal Credit Opportunity and Fair Housing Acts*

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction against persons on the basis of race, color, religion, national origin, sex, martial status, age (provided the applicant has the capacity to contract), the fact that an applicant's income derives from any public assistance program, and the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. Similarly, the Fair Housing Act (FHA) prohibits creditors involved in residential real estate transactions from discriminating against any person on the basis of race, color, religion, sex, handicap, familial status, or national origin. Unfair or deceptive practices that target or have a disparate impact on consumers who are members of these protected classes may violate ECOA, FHA, as well as the FTC Act and potentially the new DFA abusive standard.

- *Fair Debt Collection Practices Act*

The Fair Debt Collection Practices Act prohibits unfair, deceptive, and abusive practices related to the collection of consumer debts. Although the statute does not by its terms apply to financial institutions that collect their own debts, failure to adhere to the standards set by the act may support a claim of unfair or deceptive practices in violation of the FTC Act, or of abusive acts or practices under DFA. Moreover, financial institutions that either affirmatively or through lack of oversight, permit a third-party debt collector acting on their behalf to engage in deception, harassment, or threats in the collection of monies due may be exposed to liability for approving or assisting in an unfair, deceptive or abusive act or practice.

Resources

OCC Advisory Letter 2002-3 Guidance on Unfair or Deceptive Acts or Practices: www.occ.gov/static/news-issuances/memos-advisory-letters/2002/advisory-letter-2002-3.pdf; FRB/FDIC Unfair or Deceptive Acts or Practices by State-Chartered Banks: www.federalreserve.gov/boarddocs/press/bcreg/2004/20040311/attachment.pdf; 2013 FRB webinar regarding UDAP: www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/outlook-live; and CFPB's examination materials which has helpful examples to further illustrate what has been considered unfair and deceptive: http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf.

Conclusion

Financial institutions should be aware of and take into consideration the components outlined above in review of their products and services. Financial institutions should also be aware of the new standard created by the DFA. The next article will address certain types of products and services that have been found to violate Section 5 of the FTC Act.■

WISCONSIN BANKERS ASSOCIATION
Compliance Journal

Volume 17, Number 11 April 2013

Please read the inserted letter from WBA regarding an exciting, upcoming change for *WBA Compliance Journal*. Next, turn to "Special Focus" for an article regarding upcoming compliance requirements. Then, check "Regulatory Spotlight" for a statement regarding the impact of the Biggert-Waters Act. Finally, read "Compliance Notes" for an FDIC SCANS Bulletin regarding credit risk assessment for corporate, municipal, and structured securities.■

SPECIAL FOCUS

Upcoming Compliance Requirements

Notice No. 2013-4

Earlier this year, the Bureau of Consumer Financial Protection (CFPB) finalized a flurry of Dodd-Frank Act (DFA) related rules. While many of those rules carry an effective date in January 2014, there are also rules with which institutions must comply on **June 1, 2013**. This article provides an overview of the rules that become effective June 1, including new escrow requirements for higher-priced mortgage loans, the prohibition of financing single premium credit insurance on dwelling-secured loans, and the prohibition of mandatory arbitration clauses in connection with dwelling-secured loans. In addition, the article briefly describes amendments to Article 9 of Wisconsin's Uniform Commercial Code (UCC) which become effective **July 1, 2013**.

Escrow Requirements

CFPB has issued a final rule to amend Regulation Z, which implements the Truth in Lending Act (TILA), to create new requirements for escrow accounts established for higher-priced mortgage loans (HPML). The new requirements apply to transactions for which the lender receives an application after **June 1, 2013**. Regulation Z defines an HPML as a closed-end consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate (APR) that exceeds the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set by: (1) 1.5 or more percentage points for a loan secured by a first lien; (2) 2.5 or more percentage points for a loan secured by a first lien with a principal obligation at consummation that exceeds the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac (a "jumbo loan"); or (3) 3.5 or more percentage points for a loan secured by a subordinate lien. Personal property that is the consumer's principal dwelling, such as a trailer, boat, or manufactured home, is considered a "principal dwelling" for the purposes of Regulation Z.

The final rule prohibits a creditor from extending an HPML secured by a first lien unless an escrow account is established before consummation for the payment of property taxes and premiums for mortgage-related insurance that is required by the creditor. The length of time the escrow account must be maintained has been increased to a minimum of five years after consummation of the loan. Premiums for mortgage-related insurance that is not required by the creditor, such as earthquake or credit life insurance, need not be escrowed, even if the consumer voluntarily obtains such insurance. Insurance premiums are also not required to be escrowed for loans secured by condominiums, planned unit developments, or other common interest communities in which participation in a governing association is required and the governing association obtains a master policy insuring all dwellings.

Loan Type and Creditor Exceptions

There are two types of exceptions from the escrow requirements: the loan type exception and the creditor exception.

The loan type exception applies to a loan secured by shares in a cooperative, a loan to finance the initial construction of a dwelling, a temporary or bridge loan with a term of twelve months or less, and a reverse mortgage loan. If a creditor makes a construction-to-permanent loan that is classified as an HPML, the permanent phase of the loan would be subject to the escrow requirements.

The creditor exception applies to creditors which meet four requirements. First, during the preceding calendar year the creditor must have extended more than 50% of its total "covered transactions" (consumer credit transactions that

are secured by dwellings) secured by first liens on properties in counties that CFPB has designated as rural or underserved. Second, during the preceding calendar year, the creditor and its affiliates together must have originated 500 or fewer covered transactions secured by a first lien. Third, as of the preceding calendar year, the creditor must have had total assets of less than $2 billion, a figure that will be adjusted annually for inflation. Fourth, neither the creditor nor its affiliates may maintain an escrow account for any transaction secured by real property or a dwelling that they currently service through at least the second installment date.

There are two exceptions to the fourth prong, meaning that a creditor or its affiliates could maintain an escrow account and remain eligible for the creditor exception. First, escrow accounts that were established between **April 1, 2010** and **June 1, 2013** for HPMLs secured by a first lien for the purpose of complying with current HPML requirements are not counted. Creditors and their affiliates who continue to maintain escrow accounts established between April 1, 2010 and June 1, 2013 will qualify for the exception so long as they do not establish new escrow accounts for transactions consummated on or after **June 1, 2013**. Second, an escrow account established after consummation of a loan as an accommodation for a distressed consumer to assist the consumer in avoiding default or foreclosure is not counted.

Creditors may rely on a safe harbor list of counties published by the CFPB to determine whether a particular county is designated "rural" or "underserved" for a particular year. CFPB has published a preliminary list of counties and plans to publish an official list for 2013 when the recently proposed technical changes to the escrow rule are finalized, and in any event before the escrow requirements become effective.

If a creditor that is eligible for the creditor exception makes an HPML secured by a first lien that will be acquired by a purchaser pursuant to a forward commitment, the loan is subject to the escrow requirements unless the purchaser is also eligible for the creditor exception or the loan type exception applies.

Cancellation

The final rule allows cancellation of an escrow account upon the earlier of termination of the loan (through repayment, refinancing, rescission or foreclosure, among other methods) or the consumer's request. To terminate the escrow account at the consumer's request, three conditions must be met: (1) the request must be made no earlier than five years after the loan is consummated; (2) the unpaid principal balance must be less than 80% of the original value of the property securing the loan, which is determined by the lesser of the sales price or appraisal value; and (3) the consumer must not be delinquent or in default on the loan. The lender is not required to, but may, cancel an escrow account upon receiving a borrower request that meets the above criteria.

Evasion

The final rule specifically prohibits structuring a transaction as an open-end credit plan to avoid the escrow requirements.

Prohibition of Financing Single-Premium Credit Insurance

DFA amended TILA to prohibit a creditor from financing any premiums or fees for credit insurance in connection with a closed-end consumer credit transaction secured by a dwelling or an extension of open-end consumer credit secured by a consumer's principal dwelling. Within its loan originator compensation final rule, CFPB amended Regulation Z to implement this prohibition. For purposes of the prohibition, credit insurance means credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract. The final rule provides that the list of types of credit insurance is preceded by the word "means" rather than "includes," because the list in DFA seems to be exclusive.

The prohibition does not apply to credit insurance for which premiums or fees are calculated and paid in full on a

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monthly basis. It also does not apply to credit unemployment insurance for which: (1) the premiums are reasonable; (2) the creditor receives no direct or indirect compensation; and (3) the premiums are paid pursuant to a separate insurance contract and are not paid to the creditor's affiliate. CFPB has declined to define what premiums are considered "reasonable" for credit unemployment insurance. The final rule clarifies that the prohibition cannot be evaded by charging a fixed monthly premium that does not decrease as the loan balance declines, or by adding the monthly charge to the loan balance.

The prohibition does not apply to mortgage insurance, as it is distinguishable from credit insurance. Credit insurance generally protects and benefits the consumer by making the monthly payments while the consumer is unable. In contrast, mortgage insurance protects the creditor against loss in the event of default by the consumer or in other specified events.

Prohibition of Mandatory Arbitration Clauses

DFA amended TILA to prohibit a closed-end consumer credit transaction secured by a dwelling or an extension of open-end consumer credit secured by a consumer's principal dwelling from containing terms requiring arbitration or another non-judicial procedure as the method for resolving disputes arising out of the transaction. CFPB's loan originator compensation rule amends Regulation Z to implement this prohibition. In addition, the terms of the transaction cannot be applied or interpreted to bar a consumer from bringing a claim in court in connection with any alleged violation of federal law. The prohibition applies to the entire transaction, regardless of which document contains the terms.

While the agreement may not require mandatory arbitration, the consumer and creditor may nonetheless agree, after a dispute arises, to use arbitration or another non-judicial procedure to resolve the dispute. The final rule specifies that the prohibition does not limit waivers of rights to a jury trial, deeds of trust providing for non-judicial foreclosure, non-judicial foreclosures, or settlement agreements. If the consumer and creditor agree to settle a dispute or claim, the settlement agreement can be applied or interpreted to waive the consumer's right to bring *that* dispute or claim in court, even if it is a federal law claim.

Amendments to Article 9 of the UCC

Wisconsin has adopted the 2010 Amendments to Article 9 of the UCC that were approved by the National Conference of Commissioners on Uniform State Laws. Among other things, the amendments clarify which documents may be safely relied on to ensure the debtor's name is correctly listed on the UCC financing statement. The amendments become effective **July 1, 2013**.

Under the amended law, if the debtor is an individual to whom the Wisconsin Department of Transportation (DOT) has issued an operator's license or identification card that has not expired, the financing statement is sufficient if it provides the name of the individual as it appears on the operator's license or identification card. The financing statement should list the name as it appears on the operator's license or identification card even if typographical errors exist or the creditor is aware the debtor often uses another name. If the debtor is known by another name, the creditor may consider listing that name in the second "Debtor's Name" box on the UCC financing statement. While no individual should hold two operator's licenses issued in Wisconsin, in the event a debtor does hold two licenses, the creditor should use the name listed on the most recently issued license. If the debtor is an individual who does not hold an unexpired DOT-issued operator's license or identification card, the creditor may provide the debtor's surname and first personal name on the financing statement.

Examiners may view a creditor's retention of a debtor's driver's license or identification card within the loan file as a fair lending violation. For this reason, creditors that choose to retain a copy should consider retaining it within a master customer file or a processing file rather than the loan file.

If the debtor is a registered organization, the financing statement should reflect the name printed on the organization's public organic record, which is a publicly available record filed with the state to form the organization. Creditors should not rely on the name included in the state's publicly searchable database or on a certificate of good standing issued by the state, as errors may have occurred when the name was entered into the database or printed on the certificate. The amendments also address how to identify the debtor when collateral is held in a trust or by an individual's estate.

When a debtor's name changes, a financing statement that was properly filed prior to July 1, 2013 will remain effective for collateral in existence on the date of the name change, as well as for collateral acquired during the four month period after the name change. For a perfected security interest in collateral acquired after the four month period, the creditor must file an amendment providing the debtor's new name within the four month period. A creditor may choose to request a copy of the debtor's driver's license on an annual basis to ensure the debtor's name has not changed. A creditor may also choose to track a debtor's driver's license expiration date and request a copy of the debtor's newly issued license to confirm the name listed on the new license matches the name listed on the creditor's filed financing statement.

Similarly, if a debtor changes location to another jurisdiction, a creditor must file a financing statement in the

new jurisdiction within four months to maintain perfection. If this is not done, the creditor's security interest is deemed to have never been perfected.

Current UCC Article 9 allows for the filing of a "correction statement" if a person believes a filed record is inaccurate or was wrongfully filed. The amendments change the name of the filing to "information statement," and allow the secured party of record to file an information statement if the secured party believes the person who filed a record was not entitled to file it.

The UCC Financing Statement and Amendment forms have been updated to reflect the amendments. The new forms should not be used prior to **July 1, 2013**, as they do not comply with current filing requirements. While the current forms may be accepted for filings after July 1, 2013, such use of the current forms may result in an ineffective filing, so creditors should ensure use of the new forms as of **July 1, 2013**.

Conclusion

Several provisions of final rules issued by CFPB become effective **June 1, 2013**, including new requirements for escrow accounts established for HPMLs, the prohibition of financing single-premium credit insurance, and the prohibition of mandatory arbitration clauses. Institutions should be aware of these requirements and prepare to comply by June 1, 2013. The final rule on escrow requirements for HPMLs may be found at: www.gpo.gov/fdsys/pkg/FR-2013-01-22/pdf/2013-00734.pdf, and the proposal for clarifying and technical amendments to the escrow rule may be found at: http://www.gpo.gov/fdsys/pkg/FR-2013-04-18/pdf/2013-09058.pdf. The loan originator compensation final rule, which includes the prohibitions of financing single premium credit insurance and mandatory arbitration clauses, may be found at: www.gpo.gov/fdsys/pkg/FR-2013-02-15/pdf/2013-01503.pdf. CFPB has issued a number of other final rules with effective dates in January 2014, which will be discussed in future editions of *WBA Compliance Journal*.

Wisconsin has adopted amendments to Article 9 of the UCC which become effective **July 1, 2013**. The amendments are intended to provide greater certainty for secured creditors by clarifying which documents may be relied on to ensure a debtor's name is correctly listed on the UCC financing statement. The amendments were adopted within 2011 Wisconsin Act 206, which may be found at: https://docs.legis.wisconsin.gov/2011/related/acts/206. The June 2013 session of WBA Compliance Forum will include a presentation by Atty. John Knight of Boardman & Clark, llp on the amendments. The Forum will be held on June 11, 12 and 13 in Rothschild, Wisconsin Dells, and Milwaukee, respectively. Registration for the Forum is available online at www.wisbank.com/Web/Education/tabid/54/Default.aspx. WBA also hosted a phone seminar regarding the amendments on April 4, 2013. To purchase a recording of the phone seminar, please contact WBA's Gretchen Olson at golson@wisbank.com or 608-441-1252.■

REGULATORY SPOTLIGHT

Agencies Issue Guidance on Leveraged Lending.

The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) have issued guidance on leveraged lending. The guidance outlines high-level principles related to safe-and-sound leveraged lending activities, including: (1) underwriting considerations; (2) assessing and documenting enterprise value; (3) risk management expectations for credits awaiting distribution; (4) stress-testing expectations; (5) pipeline portfolio management; and (6) risk management expectations for exposures held by the institution. The guidance applies to all financial institutions supervised by the Agencies that engage in leveraged lending activities. The number of community banks with substantial involvement in leveraged lending is small; therefore, the Agencies generally expect community banks to be largely unaffected by the guidance. The guidance is effective **03/22/2013**. The compliance date for the guidance is **05/21/2013**. Copies of the guidance may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-03-22/pdf/2013-06567.pdf. *Federal Register*, Vol. 78, No. 56, 03/22/2013, 17766-17776.

Agencies Issue Statement on Impact of Biggert-Waters Act.

The Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (FRB), Farm Credit Administration (FCA) and the National Credit Union Administration (NCUA) (collectively, the Agencies) have issued an interagency statement on the impact of Biggert-Waters Act to inform financial institutions about revisions to the Flood Disaster Protection Act. The interagency guidance also provides information regarding the impact of the Biggert-Waters Act on the Agencies' proposed

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SPECIAL FOCUS

Selected CFPB Rulemakings

Notice No. 2013-5

The Bureau of Consumer Financial Protection (CFPB) recently published several rules, including: (1) a final rule to clarify the Regulation Z escrows rule; (2) a final rule to amend the Regulation E requirements for remittance transfers; (3) a final rule to repeal the requirement that a credit card applicant who is over the age of 21 have an independent ability to repay amounts extended; and (4) a proposed rule to delay the June 1, 2013 effective date of the prohibition of financing single premium credit insurance in connection with certain dwelling-secured loans. This article provides a brief overview of each rulemaking.

Amendments to 2013 Escrows Final Rule under Regulation Z

The April 2013 edition of *WBA Compliance Journal* discussed a final rule issued by CFPB in January 2013 concerning new escrow requirements (2013 Escrows Final Rule). This rule amended Regulation Z, which implements the Truth in Lending Act (TILA).

Among other things, the 2013 Escrows Final Rule lengthened the time for which a mandatory escrow account must be established and maintained for a higher-priced mortgage loan (HPML) secured by a first lien on the consumer's principal dwelling. The 2013 Escrows Final Rule also established an exemption from the escrow requirement for certain creditors that operate predominantly in "rural" or "underserved" areas.

On April 18, 2013, CFPB issued a proposed rule intended to clarify certain provisions of the 2013 Escrows Final Rule. Then, on May 16, 2013, CFPB issued a final rule (May 2013 Rule) containing clarifying and technical amendments to the 2013 Escrows Final Rule. These amendments are meant to clarify the determination method for the "rural" and "underserved" designations, and keep in place certain existing protections for HPMLs until similar provisions in several other Dodd-Frank Act final rules take effect in January 2014. These other rules include provisions in: (1) the ability to repay/qualified mortgage rule; (2) the high-cost mortgage rule; and (3) the interagency appraisal rule, all of which were issued in January 2013.

Methodology for Rural or Underserved Determination and The List

The May 2013 Rule clarifies how a county's "rural" and "underserved" status may be determined based on currently applicable Urban Influence Codes (UICs) established by the United States Department of Agriculture, Economic Research Service (USDA-ERS) (for "rural") or based on Home Mortgage Disclosure Act (HMDA) data (for "underserved") and provides illustrations to facilitate compliance.

It is important to note that in conjunction with the May 2013 Rule, CFPB has posted on its website a final list of rural and underserved counties, for use with mortgages consummated from **June 1, 2013**, through **December 31, 2013**. The final list is identical to the preliminary list posted on CFPB's website on March 12, 2013. Creditors may rely as a safe harbor on the list of counties published by CFPB to determine whether a county qualifies as "rural" or "underserved" for a particular calendar year. CFPB also noted it will post the list for use in 2014 when the relevant data becomes available.

Restoration of Certain Regulation Z Provisions Pertaining to HPMLs

The May 2013 Rule also restores certain existing Regulation Z requirements related to the consumer's ability

to repay and prepayment penalties for HPMLs that were erroneously removed in the 2013 Escrows Final Rule. The scope of these protections will be expanded under various Dodd-Frank Act rules to apply to most mortgage transactions, rather than just HPMLs, in January 2014. CFPB explained that due to this future expansion, the 2013 Escrows Final Rule removed the regulatory text providing these protections solely to HPMLs. However, the 2013 Escrows Final Rule takes effect on **June 1, 2013**, whereas the new ability-to-repay and prepayment penalty provisions under other Dodd-Frank Act rules do not take effect until **January 10, 2014**. Thus, to prevent any interruption in applicable protections, the May 2013 Rule establishes a temporary provision to ensure the protections are restored and remain in place for HPMLs until the expanded provisions take effect in January 2014.

Effective Dates

The May 2013 Rule is effective **June 1, 2013**, except that provisions restoring protections for HPMLs will be effective from **June 1, 2013** through **January 9, 2014**.

Remittance Transfer Requirements under Regulation E

On February 7, 2012, CFPB issued a final rule to amend Regulation E, which implements the Electronic Fund Transfer Act, to implement Dodd-Frank Act mandated requirements for remittance transfers. The February 2012 final rule was amended by subsequent final rules issued on July 10, 2012 and August 20, 2012. The effective date for the 2012 final rules was February 7, 2013, but the effective date was delayed by a final rule issued by CFPB on January 29, 2013. On April 30, 2013, CFPB issued another final rule (2013 final rule) to further amend the Regulation E requirements for remittance transfers.

The 2013 final rule affects three main components of the requirements for remittance transfers. First, the 2013 final rule makes optional the disclosure of taxes collected by parties other than the remittance transfer provider. Second, it makes optional the disclosure of fees imposed by third parties with which the provider has no relationship, and instead requires a disclaimer that other fees and taxes may apply. Third, the 2013 final rule revises the definition of "error" to exclude instances where the sender provides an incorrect account number or recipient institution identifier.

Optional Disclosure of Foreign Taxes and Third Party Fees

Within the 2013 final rule, CFPB explains that requiring the disclosure of taxes that are collected by parties other than the remittance transfer provider (foreign taxes) may have discouraged transfers to jurisdictions where gaining access to the required information would have been difficult or impossible. In addition, the cost to providers in obtaining the necessary information may have exceeded the benefit to consumers, as the foreign taxes would likely apply to any transfer sent to the particular country and would therefore not aid the consumer in comparison shopping.

The 2013 final rule creates the term "non-covered third-party fees," which is defined as any fee imposed by the designated recipient's institution for receiving a remittance transfer into an account, except if the designated recipient's institution acts as an agent of the remittance transfer provider. Disclosure of non-covered third-party fees is optional under the 2013 final rule. If the recipient institution is an agent of the remittance transfer provider or has a direct relationship with the provider, such as an intermediary institution that is the provider's correspondent bank, the fees imposed are considered "covered third-party fees" and must be disclosed to the sender.

In lieu of the disclosure of foreign taxes and non-covered third-party fees, the provider must include a disclaimer to alert the sender that other fees and taxes may reduce the amount received by the designated recipient of the transfer. The disclaimer must be clear and conspicuous, and in close proximity to the information regarding the amount to be received. The model forms provided in Appendix A to Regulation E have been revised to include sample language for the disclaimer. If the provider is aware that no taxes or non-covered third-party fees will be assessed on the transfer, the disclaimer may not be included on the disclosures for the transfer.

To encourage the optional disclosure of non-covered third-party fees and foreign taxes, the 2013 final rule affords flexibility in disclosing the information. Providers may estimate the amounts using "reasonable sources of information," such as fee schedules received from recipient

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institutions, surveys of recipient institution fees in the same country or region as the recipient institution, information provided by regulatory or taxing authorities, or commercially or publicly available databases. While the provider may choose to include amounts of non-covered third-party fees and foreign taxes in the disclosures, such amounts must not, under any circumstance, be included in the calculation of the amount the designated recipient will receive. In addition, a discrepancy between the disclosed amount to be received by the designated recipient and the amount actually received due to the application of non-covered third-party fees or foreign taxes no longer meets the definition of "error."

Incorrect Information Provided by Sender

Under the 2012 final rules, a remittance transfer provider could have been liable for the amount of a transfer if it was not received by the designated recipient, even if the transfer was not properly received due to incorrect information provided by the sender. The 2013 final rule amends the definition of "error" to exclude instances where the sender provides an incorrect account number or recipient institution identifier. The commentary clarifies that the terms account number and recipient institution identifier refer to alphanumerical account or institution identifiers other than names or addresses, such as account numbers, routing numbers, or other similar account or institution identifiers.

If a sender provides an incorrect account number or recipient institution identifier, the remittance transfer provider may avoid liability for the amount of the transfer if the incorrect information results in a mis-deposit of the funds and five other conditions are met. First, the provider must demonstrate that the sender provided an incorrect account number or recipient institution identifier. Second, the provider must have used reasonably available means to verify the recipient institution identifier before the transfer was sent. Reasonably available means may include accessing a directory of Business Identifier Codes to confirm that the code provided by the sender matches the institution name provided by the sender. Third, the provider must have provided notice to the sender before the sender authorized the transfer that an incorrect account number or recipient institution identifier could result in the misdirection of the funds and that the sender could lose the funds. Fourth, the provider must demonstrate that the funds were deposited into the wrong account. Finally, the provider must use reasonably available means to attempt to recover the funds for the sender. The final rule does not mandate specific methods that a provider must use to attempt to recover the funds, as the circumstances surrounding individual transfers can vary greatly, and a method that may be considered reasonable for one transfer may be unreasonable for another. The commentary provides examples of reasonable efforts to recover the funds, including promptly calling or otherwise contacting the institution that received the transfer to request that the amount be returned.

If an error, as defined by the rule, occurs due to incorrect or insufficient information provided by the sender (other than an incorrect account number or recipient institution identifier), the appropriate remedy is a refund of the transfer amount within three business days of the provider's confirmation of the error. The 2013 final rule allows for the amount of third party fees or taxes that were imposed in connection with the transfer to be deducted from the amount of the refund to the sender, provided that the amounts will not be refunded to the provider, and to the extent that such refunds are not prohibited by law. In lieu of a refund, the sender may request that the provider resend the funds, if the request is made after the refund amount has been calculated but before the refund has been processed. Such a transaction is treated as a new transfer subject to all of the remittance transfer disclosure requirements imposed by Regulation E.

Amended Effective Date

The 2013 final rule provides that the Regulation E requirements for remittance transfers become effective **October 28, 2013**.

Independent Ability to Repay Credit Card Debt under Regulation Z

On May 3, 2013 CFPB issued a final rule to amend the requirements applicable to credit card issuers in considering applicants' ability to make required payments under the terms of the credit card account. The Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit Card Act) amended TILA to prohibit credit card issuers from opening a credit card account or increasing a line of credit for any consumer unless the issuer considers the consumer's ability to make the required payments under the terms of the account. The Credit Card Act also established special requirements for consumers under the age of 21. CFPB issued the final rule to amend Regulation Z, which implements TILA, to address concerns that the previous statutory framework unduly limited the ability of consumers, particularly those who do not work outside the home, to obtain credit.

The final rule removes references to an "independent" ability to pay standard in section 1026.51(a) of Regulation Z, which applies to consumers over the age of 21, and allows credit card issuers to consider income and assets to which an applicant over the age of 21 has a reasonable expectation of access. The final rule maintains the independent ability to pay requirement for consumers under the age of 21 outlined in section 1026.51(b) of Regulation Z. The final rule also provides a safe harbor that compliance with the independent ability to pay requirements for consumers under age 21 does not violate the Regulation B prohibition against age-based discrimination.

Removal of "Independent" Ability to Pay Standard for Consumers over Age 21

The Credit Card Act added section 150 to TILA to prohibit credit card issuers from opening a credit card account or increasing a credit limit without considering the consumer's ability to make the required payments. The text of section 150 does not reference an independent ability to pay standard. The Credit Card Act also added TILA section 127 (c)(8) which provides that a credit card may not be issued to a consumer under the age of 21 who does not have an independent ability to make the required payments on the account, unless the consumer's application contains the signature of a "cosigner" or joint applicant who is at least 21 and has means to repay debts incurred in connection with the account. While TILA maintains this distinction depending on the consumer's age, a final rule issued by the Board of Governors of the Federal Reserve on March 18, 2011 applied the independent ability to pay standard to all consumers, regardless of age. To address any unintended adverse impact on the ability of individuals over the age of 21 to obtain credit, including those who do not work outside the home, CFPB issued the final rule to remove the independent ability to pay standard for consumers over the age of 21.

Income or Assets to which Consumer has a Reasonable Expectation of Access

The final rule retains the requirement that card issuers establish reasonable written policies and procedures to consider the consumer's ability to make the required minimum payments under the terms of the account based on the consumer's income or assets and current obligations. The final rule provides that within such policies and procedures, issuers may, but are not required to, include consideration of any income or assets to which a consumer over the age of 21 has a reasonable expectation of access.

The final rule amends the commentary to section 1026.51(a) of Regulation Z to identify when a consumer has a reasonable expectation of access to income or assets of another person. For example, if a non-applicant's salary is deposited regularly into a joint account shared with the applicant, a card issuer is permitted to consider the amount of the non-applicant's income that is regularly deposited into the account to be the applicant's current or reasonably expected income. Similarly, if a non-applicant's income is deposited into an account to which the applicant does not have access, but the non-applicant regularly transfers a portion of that income into an account owned by the applicant, a card issuer may consider the amount that is regularly transferred into the applicant's account to be the applicant's current or reasonably expected income. If a federal or state law grants the applicant an ownership interest in the income or assets of another person, such as the Wisconsin Marital Property Act, such income or assets may be considered the applicant's current or reasonably expected income or assets.

Rules Affecting Young Consumers

As outlined above, section 1026.51(b) of Regulation Z prohibits a credit card issuer from opening an account for a consumer under the age of 21 unless the consumer has the independent ability to make the required payments under the terms of the account, or the consumer's application includes the signature of a "cosigner," guarantor, or joint applicant who is at least 21 years old and has the ability to make the required payments on the account. The final rule issued by CFPB retains this requirement, and provides that a card issuer may consider the reasonably expected income or assets of an applicant who is under age 21, but may not consider income or assets to which a consumer under the age of 21 only has a reasonable expectation of access. For those persons over the age of 21, the credit card issuer may consider income and assets to which the person has a reasonable expectation of access.

For credit card accounts opened for consumers under the age of 21, the credit card issuer may not increase the credit limit on the account before the consumer reaches the age of 21 unless, at the time of the contemplated increase, the consumer has an independent ability to make the required payments on the increased limit or a "cosigner," guarantor, or joint applicant who is at least 21 years old and has the ability to make the required payments on the account agrees in writing to assume liability for any debt incurred on the account. If a "cosigner," guarantor or joint applicant who is at least 21 years old agreed at the time the credit card account was opened to assume liability for any debt on the account, the credit limit on the account must not be increased before the consumer reaches the age of 21 unless the "cosigner," guarantor, or joint accountholder agrees in writing to assume liability on the increased limit.

Safe Harbor from Age Discrimination Claims

The final rule amends the commentary to section 1026.51(b) of Regulation Z to clarify that a card issuer would not violate Regulation B by virtue of its compliance with the independent ability to pay requirements for consumers under the age of 21.

Effective Date

The final rule became effective upon its publication in the *Federal Register*, on **May 3, 2013**. Credit card issuers are required to comply with the final rule no later than **November 3, 2013**, but may choose to comply with the final rule as of **May 3, 2013**.

Delayed Effective Date for Prohibition on Financing Single-Premium Credit Insurance

The final rule regarding Loan Originator Compensation under TILA issued by CFPB on January 20, 2013 created

section 1026.36(i) of Regulation Z, which prohibits the financing of single-premium credit insurance in connection with certain consumer credit transactions secured by dwellings. The final rule provided an effective date of **June 1, 2013** for the prohibition. On May 7, 2013, CFPB issued a proposed rule to temporarily delay the effective date of the prohibition. Comments on the proposed rule must be submitted by **May 25, 2013**; CFPB will then presumably issue a final rule to temporarily delay the effective date.

The final rule issued January 20, 2013 prohibits creditors from financing any premiums or fees for credit insurance in connection with any closed-end consumer credit transaction secured by a dwelling or with any extension of credit under an open-end consumer credit plan secured by the consumer's principal dwelling. The prohibition applies to credit life, credit disability, credit unemployment, credit property insurance, and other similar products, but does not apply to credit insurance for which premiums or fees are calculated and paid in full on a monthly basis. The prohibition also does not apply to credit unemployment insurance for which the premiums are reasonable, the creditor receives no compensation, and the premiums are paid pursuant to a separate insurance contract and are not paid to the creditor's affiliate.

The temporary delay will allow CFPB to clarify the prohibition's applicability to transactions other than those in which a lump sum premium is added to the loan amount at closing. According to the proposed rule issued May 7, 2013, CFPB intends to issue a proposal in June 2013 regarding the applicability of the prohibition to transactions in which credit insurance premiums are charged periodically, and to propose a new effective date for the prohibition.

Conclusion

CFPB has been very busy issuing numerous final and proposed rules to clarify rules it has previously issued. First, CFPB issued a final rule on the Regulation Z escrows rule to clarify the methodology used in determining counties which are "rural" or "underserved," and to restore certain existing protections for HPMLs. The May 2013 Rule may be found at: http://files.consumerfinance.gov/f/201305_cfpb_Escrows-Clarifications-final-rule.pdf, and the 2013 final list of rural or underserved counties may be found at: http://www.consumerfinance.gov/blog/final-list-of-rural-and-or-underserved-counties-for-use-in-2013/.

Second, CFPB also issued a final rule amending the remittance transfer requirements imposed by Regulation E which makes optional the disclosure of taxes collected by parties other than the remittance transfer provider, as well as fees imposed by third parties with which the provider does not have a direct relationship. The final rule amending Regulation E may be found at: http://www.gpo.gov/fdsys/pkg/FR-2013-05-22/pdf/2013-10604.pdf. For further information regarding the requirements for remittance transfers, please see the March 2012 and September 2012 editions of *WBA Compliance Journal*.

Third, CFPB issued a final rule to amend the requirements regarding consideration of a credit card applicant's ability to repay amounts extended under the credit card account. The final rule may be found at: www.gpo.gov/fdsys/pkg/FR-2013-05-03/pdf/2013-10429.pdf.

Fourth, CFPB issued a proposed rule to temporarily delay the prohibition of financing single-premium credit insurance in connection with certain dwelling-secured loans. The proposed rule may be found at: www.gpo.gov/fdsys/pkg/FR-2013-05-10/pdf/2013-11223.pdf.

Finally, creditors can expect CFPB to continue to issue additional clarifying rules on various mortgage reform rules in the coming months.■

REGULATORY SPOTLIGHT

Agencies Issue Proposed Rules on Deposit Advance Products.

- The Federal Deposit Insurance Corporation (FDIC) has proposed supervisory guidance regarding deposit advance products. The proposed guidance details the principles that FDIC expects FDIC-supervised financial institutions to follow in connection with any deposit advance product to address potential reputational, compliance, legal and credit risks. FDIC expects institutions to apply the principles set forth in the guidance to any deposit advance product they offer. Comments are due **05/30/2013**. Copies of the proposed guidance may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-04-30/pdf/2013-10101.pdf. *Federal Register*, Vol. 78, No. 83, 04/30/2013, 25268-25273.

- The Office of the Comptroller of the Currency (OCC) has proposed guidance on safe and sound banking practices and consumer protection in connection with deposit advance products. OCC has also withdrawn its previously proposed guidance on Deposit-Related Consumer Credit

WISCONSIN BANKERS ASSOCIATION
Compliance Journal

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Read "Special Focus" for a time-sensitive article regarding a final rule amending an interim rule on garnishment of accounts containing federal benefit payments. Next, read "Regulatory Spotlight" for numerous CFPB regulations. Finally, turn to "Compliance Notes" for an item on a new Freddie Mac "Low Volume" fee and WBA's letter objecting to such fee.■

SPECIAL FOCUS

Final Garnishment of Accounts Containing Federal Benefit Payments Rule

Notice 2013-6

After much waiting, the Department of Treasury, Social Security Administration, Department of Veteran Affairs, Railroad Retirement Board, and Office of Personnel Management (collectively, the Agencies) have finally published a final rule to implement statutory restrictions and protections on garnishment of certain federal benefit payments.

The rule establishes procedures that financial institutions must follow when they receive a garnishment order against an account holder who receives certain types of federal benefit payments by direct deposit. The rule requires financial institutions that receive such a garnishment order to determine the sum of such federal benefit payments deposited to the account during a two-month "lookback" period, and to ensure that the account holder has access to an amount equal to that sum or to the current balance of the account, whichever is lower.

The final rule, effective **June 28, 2013**, amends select portions of the Agencies' previously issued February 2011 interim rule (interim rule). This article outlines the amendments made to the interim rule and supplements the previously published article on the topic as found in the March 2011 *WBA Compliance Journal*.

Revised Definitions

The final rule revises three definitions which will impact financial institutions' existing procedures when receiving a garnishment order. Those revised definitions, and the Agencies' rationale for the revisions, are outlined below.

Benefit payment means a federal benefit payment referred to in section 212.2(b) of the rule paid by direct deposit to an account with the character "XX" encoded in positions 54 and 55 of the Company Entry Description field and the number "2" encoded in the Originator Status Code field of the Batch Header Record of the direct deposit entry.

The Agencies added the "2" code because of the possibility that payments other than federal payments could contain an "XX" encoded in positions 54 and 55. The additional code will further assist financial institutions in identifying protected federal payments.

Garnishment order or *order* means a writ, order, notice, summons, judgment, levy or similar written instruction issued by a court, a state or state agency, a municipality or municipal corporation, or a state child support enforcement agency, including a lien arising by operation of law for overdue child support or an order to freeze the assets in an account, to effect a garnishment against a debtor.

Since the Agencies have broadened the definition of "garnishment order" to now include orders and levies issued by a state or state agency or municipality, this means that state-issued levies, such as Wisconsin's Department of Revenue (DOR) tax levies and Department of Workforce Development (DWD) unemployment levies, to name a few examples, are potentially impacted by the final rule. This was not the case under the interim rule.

Protected amount means the lesser of: (1) the sum of all benefit payments posted to an account between the close of business on the beginning date of the lookback period and the open of business on the ending date of the lookback period; or (2) the balance in an account when the account review is performed.

The Agencies amended the definition of "protected amount" to provide that the relevant account balance is the account balance when the account review is performed so that the balance will include intraday items such as ATM or cash withdrawals. From an operational perspective, this is a helpful revision to the interim rule. For example, if $1,000 in protected funds were deposited during the lookback period, and the account balance was $600 at the open of business on the date of the account review, then the protected amount would be $600. If, however, the account review is performed in the afternoon, and all of the $600 had been withdrawn by the time the account review was performed, then the financial institution would be in the position of establishing and providing access to a $600 protected amount for an account containing no funds. To address this incongruity, the Agencies amended the interim rule to provide that the relevant account balance is the account balance when the account review is performed. Thus, in the latter example under the final rule, there would be no protected amount.

The final rule also clarified that financial institutions should not use the Regulation CC available funds balance, but should be aware that the requirement to provide access to the protected amount is subject to the usual restrictions on funds availability under Regulation CC. Also, the Agencies do not intend that any line of credit associated with the account be considered as part of the "account balance" for the purpose of determining a protected amount.

Revised Notice Requirement

The final rule provides that financial institutions must send notice to the account holder where: (1) a benefit agency has deposited a benefit payment into an account during the lookback period; (2) the balance in the account on the date of account review was above zero dollars and the financial institution has established a protected amount; and (3) there are funds in the account in excess of the protected amount.

Thus, the final rule revises the interim rule to require a notice to an account holder only in cases where there are funds in the account in excess of the protected amount. The Agencies made this change as they agreed with commenters to the interim rule that a requirement to send a notice to an account holder in cases where there are no funds in excess of the protected amount may be of little benefit, and is likely to result in unnecessary confusion for some account holders.

The final rule also clarifies that it is acceptable for financial institutions to: mail the notice to the address of record; deliver the notice to all account holders of a joint account; and deliver the notice by any method agreed to between the financial institution and the account holder—as the rule does not specify the means of delivery of the notice. This could include electronic delivery.

Revised Garnishment Fee Provision

The final rule retains the prohibition set forth under the interim rule in which financial institutions cannot charge or collect a garnishment fee against a protected amount. However, the final rule revises the interim rule to permit the institution to charge or collect a garnishment fee up to five business days after the account review if funds other than a benefit payment are deposited to the account—provided that the fee does not exceed the amount of the non-benefit deposited funds.

While the Agencies' final rule provides for up to a five-day delay for the collection of a charge to the account holder for a garnishment fee, it is recommended that financial institutions first discuss such a procedure with their own legal counsel before implementing this provision of the Agencies' final rule.

Resources

Financial institutions should review current garnishment procedures and make revisions where necessary. As the Agencies have only revised select portions of the interim rule, institutions must consider both the interim and final rules in the review process. Those rules may be found at the following links, respectively: http://www.gpo.gov/fdsys/pkg/FR-2011-02-23/pdf/2011-3782.pdf and http://www.gpo.gov/fdsys/pkg/FR-2013-05-29/pdf/2013-12567.pdf. WBA Education will be hosting a telephone webinar on the topic **July 30, 2013**. Please see the education section on WBA's website for more information.■

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Read "Special Focus" for an article regarding CFPB's rules on the ability to repay and qualified mortgages. Next, check "Judicial Spotlight" for a Wisconsin Supreme Court case concerning guarantors. Then turn to "Regulatory Spotlight" for numerous CFPB items. Finally, read "Compliance Notes" for FAQs on the new Treasury garnishment rule. ■

SPECIAL FOCUS

Ability to Repay/Qualified Mortgage Requirements under Regulation Z

Notice No. 2013-7

Among the various mortgage-related final rules issued by the Consumer Financial Protection Bureau (CFPB) in January 2013 is the final rule outlining Ability to Repay and Qualified Mortgage Standards under the Truth in Lending Act. The rule requires a creditor to make a reasonable, good faith determination, before consummating a mortgage loan, that the consumer has a reasonable ability to repay the loan according to its terms. Creditors may comply with the rule by following the general ability to repay standard, which requires consideration of specified factors in the underwriting process, or by originating a "qualified mortgage" (QM), which provides the creditor with either a safe harbor or rebuttable presumption of compliance. The effective date for the final rule is **January 10, 2014**.

This article is intended to provide an overview of the Ability to Repay/Qualified Mortgage final rule, as well as subsequent final rules issued to amend the initial final rule, but does not address every aspect of the rules.

Scope

The Ability to Repay/Qualified Mortgage final rule applies to nearly all closed-end consumer credit transactions secured by dwellings. Loans secured by residential structures containing one to four units are covered, including condominiums and co-ops. Loans secured by subordinate liens, as well as loans secured by dwellings that are not primary residences, are subject to the rule.

The rule does not apply to a loan secured by a consumer's interest in a timeshare, a reverse mortgage loan, a temporary or bridge loan with a term of twelve months or less, or the construction phase of twelve months or less within a construction-to-permanent loan. The rule also does not apply to open-end credit plans, such as HELOCs, or to loans secured by vacant land.

Certain non-profit and community-based lenders are exempted from the rule's requirements. Such creditors may make no more than 200 loans per year and must lend only to low- and moderate-income consumers. Mortgage loans made through a housing finance agency or certain homeownership stabilization or foreclosure prevention programs are also exempt.

In order to provide creditors additional flexibility in serving their current mortgage loan customers, when a creditor refinances a current mortgage loan customer from a "non-standard mortgage" to a "standard mortgage", the resulting loan is not subject to the ability to repay rule. A "non-standard mortgage" is an adjustable-rate mortgage (ARM) loan, an interest-only loan, or a negative amortization loan. To be a "standard mortgage" and fall within this exception, the refinanced loan must meet several requirements: (1) the consumer's principal balance may not increase; (2) the consumer's monthly payment must decrease by at least 10%; (3) the loan may not include negative amortization, interest-only payments, or a balloon payment; (4) the loan term may not exceed 40 years; (5) the interest rate must be fixed for at least the first five years of the loan; and (6) the total points and fees payable in connection with the loan may not exceed specified amounts, as discussed below. To qualify for this exception, the consumer must have made no more than one payment over 30 days late in the preceding twelve months, and no late payments within the preceding six months. The consumer's written application to refinance into a standard mortgage must be received by the creditor no later than two months after the non-standard mortgage has "recast", meaning when the time period for introductory fixed rate payments on an ARM loan ends, or when the time period for interest-only or negative amortization payments ends. The creditor must consider whether extending the standard mortgage loan will likely prevent the consumer from defaulting on the non-standard mortgage loan once the loan is recast. Finally, the consumer must use the proceeds

to pay off the original mortgage and for closing and settlement charges; the consumer may not complete a "cash-out refinance."

Ability to Repay Standard and Requirements

The final rule requires a creditor to make a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms. The general ability to repay standard requires that a creditor consider and verify the following eight specific factors when underwriting an application for a covered transaction:

1. the consumer's current or reasonably expected income or assets, other than the value of the dwelling and any real property attached to the dwelling that will secure the loan;
2. the consumer's current employment status, if the creditor relies on income from the consumer's employment in determining repayment ability;
3. the consumer's monthly payment on the covered transaction;
4. the consumer's monthly payment on any simultaneous loan that creditor knows or has reason to know will be made;
5. the consumer's monthly payment on mortgage-related obligations, such as property taxes and insurance required by the creditor, as well as other costs related to the property, such as homeowners association fees;
6. the consumer's current debt, alimony, and child support obligations;
7. the consumer's monthly debt-to-income ratio or residual income calculated using the total of all monthly mortgage and non-mortgage obligations, as a ratio of the consumer's gross monthly income; and
8. the consumer's credit history.

With respect to the consumer's income, a creditor may consider: (1) earned income, such as wages or salary; (2) unearned income, such as interest and dividends; and (3) other regular payments to the consumer, such as alimony, child support, or government benefits. Earned income is not required to be salaried or from full-time employment to be considered; creditors may consider part-time, seasonal, military and bonus income as well.

Creditors must calculate monthly payments by assuming the loan is repaid in substantially equal monthly payments during its term. To be substantially equal, no two monthly payments may vary by more than one percent. For loans paid quarterly or annually, payment amounts must be converted to monthly figures when determining the consumer's ability to repay. The monthly payment for an ARM loan must be calculated using either the fully indexed rate or introductory rate, whichever is higher. Special monthly payment calculation rules apply to loans with balloon payments, interest-only payments, or negative amortization, as discussed below.

For a balloon loan, the monthly payment calculation method depends on whether the loan is a higher-priced loan. Under the general ability to repay standard, higher-priced loans are defined as those having an annual percentage rate (APR) that exceeds the Average Prime Offer Rate (APOR) for a comparable transaction by 1.5% or more for first lien loans, and by 3.5% or more for subordinate lien loans. For higher-priced balloon loans, the creditor must use the maximum payment in the payment schedule, including any balloon payment. For balloon loans that are not higher-priced, the creditor must use the maximum payment scheduled during the first five years after the first regular periodic payment comes due.

For interest-only loans, the greater of the fully-indexed or introductory rate must be used, and the creditor must base its calculations on equal monthly payments of principal and interest that will repay the outstanding loan amount on the date the loan recasts over the remaining term.

For negative amortization loans, the creditor must calculate the maximum loan amount, including the potential additional principal, assuming the consumer will make the minimum required payments until the date the loan recasts. The greater of the fully-indexed or introductory rate must be used, and the creditor must base its calculations on equal monthly payments of principal and interest that will repay the maximum loan amount on the date the loan recasts over the remaining term.

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Verification of Information

The information considered by the creditor in making the ability to repay determination must be verified using reasonably reliable third party records. The term "third party record" is defined as a record prepared or reviewed by an appropriate person other than the consumer, the creditor, or the mortgage broker; a copy of a tax return filed with the IRS or a state taxing authority; a record the creditor maintains for an account belonging to the consumer that is held by the creditor; or, if the consumer is an employee of the creditor or mortgage broker, a document or other record maintained by the creditor or mortgage broker regarding the consumer's employment status or employment income.

Creditors generally may not rely on consumers' verbal statements regarding income. A creditor may verify an applicant's income through a phone call to the applicant's employer if the creditor maintains a record of the information received during the phone call. If, in the creditor's reasonable judgment, the consumer has more income than is needed to repay the loan, the creditor is not required to verify the extra income. For example, if a consumer has both a full-time job and a part-time job, and the creditor determines that the consumer's income from the full-time job is sufficient to repay the loan, the creditor need not verify income from the consumer's part-time job.

The consumer's credit report may be used to verify the consumer's debt obligations; a creditor is not required to obtain individual statements for each of the debts. In the event a consumer lists a debt on the credit application which does not appear on the consumer's credit report, the creditor may rely on the consumer's statement regarding the existence and amount of the debt without further verification. Debts paid in full at or before consummation of the loan should not be considered in the ability to repay determination.

Ability to Repay Determination

The ability to repay standard requires the creditor to consider the applicant's debt-to-income (DTI) ratio or residual income, but does not mandate a specified DTI ratio or residual income threshold. The rule also does not dictate a specific underwriting model; creditors are not prohibited from employing their own underwriting standards or considering factors in addition to those required by the rule. Creditors should review their current underwriting policies and procedures to ensure they reflect the creditor's consideration of each of the eight required factors within the ability to repay determination.

The official commentary to Regulation Z, which implements the Truth in Lending Act, provides that whether a particular determination regarding a consumer's ability to repay is reasonable and in good faith will depend on the underwriting standards adopted by the creditor, and on the facts and circumstances of the particular extension of credit. A consumer's statement that the consumer has the ability to repay the loan is not indicative of whether the creditor's determination was reasonable and in good faith.

Elements which may be evidence that the determination was reasonable and in good faith include: (1) the consumer's demonstration of actual ability to repay the loan by having made timely payments for a significant period of time after consummation; (2) the creditor used underwriting standards which have historically resulted in comparatively low rates of delinquency or default during adverse economic conditions; or (3) the creditor used underwriting standards based on empirically derived, demonstrably and statistically sound models.

Conversely, elements which may serve as evidence that the determination was not reasonable or in good faith include: (1) the creditor ignored evidence that its underwriting standards were not effective in determining consumers' repayment ability; (2) the creditor applied underwriting standards inconsistently or used underwriting standards different from those used in similar loans without a reasonable justification for the variance; or (3) the consumer defaulted early in the loan term, without having experienced a significant financial challenge or life-altering event.

As the creditor's determination regarding ability to repay must be made at the time of consummation of the loan, a change in the consumer's circumstances after consummation which could not have been reasonably anticipated is not relevant to determining a creditor's compliance with the rule. However, if a consumer has trouble repaying a loan, the consumer may claim that the creditor failed to make a reasonable, good-faith determination of the consumer's repayment ability when the loan was made. If the consumer prevails in court, the creditor could be liable for up to three years of finance charges and fees paid by the consumer, as well as the legal fees incurred by the consumer in bringing the claim. A three-year statute of limitations applies to affirmative claims brought by consumers. After the three year time frame, a consumer could assert the claim in a defense to a foreclosure action.

Five Categories of Qualified Mortgages

While creditors may choose to comply with the requirements under the general ability to repay standard outlined above in underwriting a loan, creditors also have the option of making a "qualified mortgage" (QM) by meeting certain separate requirements. When a creditor extends a QM loan, the creditor is entitled to a safe harbor or presumption of compliance with the ability to repay requirements, providing greater legal protection in the event the creditor's compliance with the rule is challenged.

There are five categories of QM loans, two of which are temporary in nature. To originate a loan that is considered a QM, the transaction may not include certain features deemed risky by CFPB, certain loan costs are limited, and certain underwriting criteria must be met. QM loans that are not higher-priced are afforded a safe harbor, where compliance with the ability to repay requirements is conclusively presumed. Higher-priced QMs receive a rebuttable presumption of compliance with the requirements, meaning that the consumer must show that based on the information available to the creditor at consummation of the loan, the consumer did not have sufficient residual income to meet living expenses after paying the mortgage loan and other debts. The rebuttable presumption provides more legal protection to a creditor than mere compliance under the general ability to repay standard, but less protection than the safe harbor. Separate thresholds are used in determining whether a loan is higher-priced under the ability to repay standard and under the QM categories, as discussed below.

General QM

The first QM category is referred to as the "general QM". To be deemed a general QM, the transaction must provide for regular periodic payments that are substantially equal, except for the effect that any interest rate change after consummation may have on the payment in the case of an adjustable-rate or step-rate mortgage. The transaction may not include negative amortization, interest-only payments, or a balloon payment, and the term of the loan may not exceed thirty years. In addition, the total points and fees payable in connection with the loan may not exceed specified amounts, as discussed below.

In underwriting the loan, the creditor must consider the monthly payment for all mortgage-related obligations, using the maximum interest rate that may apply during the first five years after the due date of the first periodic payment. The consumer's income and assets, current debt, alimony and child support obligations must be considered and verified. The consumer's total monthly DTI ratio may not exceed 43%, and must be calculated using the standards provided in Appendix Q to Regulation Z.

Temporary/Government Patch QM

The second QM category applies to loans which meet certain requirements and are eligible for purchase or guarantee by Fannie Mae or Freddie Mac (government sponsored entities, or GSEs), or are eligible for insurance or guarantee by specified federal agencies. This category will exist for a transitional period of up to seven years following the final rule's effective date of January 10, 2014, as outlined in further detail below.

To qualify as a QM under this category, a loan's terms and conditions must not contain negative amortization, interest-only payments, a balloon payment, or a term greater than 30 years. The loan must comply with the points and fees test discussed below. In addition, the loan must be eligible to be: (1) purchased or guaranteed by one of the GSEs; (2) insured by the Federal Housing Administration; (3) insured by the U.S. Department of Housing and Urban Development; (4) guaranteed by the U.S. Department of Veterans Affairs; (5) guaranteed by the U.S. Department of Agriculture; or (6) insured by the Rural Housing Service. While the loan must be underwritten using the required guidelines of the applicable entity and must be eligible for purchase, guarantee or insurance, there is no requirement that the loan actually be sold to, guaranteed by or insured by the applicable entity to be a QM. In addition, the 43% DTI ratio limitation does not apply to this QM category.

In determining whether a loan is eligible for purchase, guarantee or insurance by one of the listed agencies, creditors are not required to consider agencies' underwriting or eligibility guidelines that are wholly unrelated to the consumer's ability to repay, such as matters unrelated to credit risk or the underwriting of the loan. The official commentary to Regulation Z outlines that matters wholly unrelated to ability to repay include: (1) requirements related to the status of the creditor rather than the loan; (2) requirements related to selling, securitizing or delivering the loan; and (3) any requirement that the creditor must perform after the consummated loan is sold, guaranteed or endorsed for insurance, such as document custody, quality control, or servicing.

With respect to loans eligible for purchase or guarantee by the GSEs, this temporary QM category will expire on the date the GSEs exit federal conservatorship or receivership, or January 10, 2021, whichever occurs first. For loans eligible to be insured or guaranteed by the listed federal agencies, this QM category will expire on the effective date of a rule issued by each respective agency pursuant to its authority under the Truth in Lending Act to define a qualified mortgage, or January 10, 2021, whichever occurs first. Loans which receive QM status under this category during the transitional period will retain QM status after the transitional period ends. Loans consummated after the expiration of the transitional period must meet the requirements of another QM category to be afforded QM status.

Balloon Loan QM by Creditors Serving Rural or Underserved Areas

The third QM category is available only to creditors which meet three requirements. First, more than 50% of the creditor's consumer credit transactions secured by dwellings ("covered transactions") extended in the preceding calendar year which were secured by first liens must have been secured by properties located in counties designated as either "rural" or "underserved." CFPB maintains a list of counties designated as either rural or underserved, which

will be updated on an annual basis. Second, the creditor, along with its affiliates, must have originated no more than 500 first lien covered transactions in the preceding calendar year. Third, as of December 31 of the preceding calendar year, the creditor must have total assets not exceeding $2 billion, a figure which will be adjusted annually for inflation.

Creditors which meet these requirements may make a QM loan that includes a balloon payment, provided certain other conditions are met. The loan may not have negative amortization or interest-only features, and the points and fees test discussed below must be met. The loan must have a fixed interest rate and provide for periodic payments, excluding the balloon payment, which would fully amortize the loan over a period of 30 years or less. The term of the loan must be at least 5 years. At consummation the loan cannot be subject to a forward commitment, unless it will be acquired by a creditor which is also eligible to make balloon payment QM loans under this category.

The creditor is required to determine that the consumer will be able to make the scheduled periodic payments under the terms of the loan, excluding the balloon payment, together with the monthly payments for all mortgage-related obligations, from the consumer's current or reasonably expected income or assets. In underwriting the loan, the creditor must consider and verify the consumer's income or assets and debt, alimony and child support obligations. The creditor must also consider and verify the consumer's DTI ratio or residual income, but the 43% DTI ratio requirement does not apply to this QM category and the creditor is not required to comply with the standards outlined in Appendix Q.

A balloon payment QM sold within three years of consummation will lose its QM status, unless it is: (1) sold to another creditor eligible to make balloon payment QMs under this category; (2) sold pursuant to a supervisory action or agreement, or the instructions of a person acting as conservator, receiver, or bankruptcy trustee; or (3) transferred as part of a merger or acquisition of the creditor. A balloon payment QM sold more than three years after consummation will retain its QM status.

Small Creditor Portfolio Loan QM

The fourth QM category applies to creditors with less than $2 billion in total assets (a figure which will be adjusted annually for inflation) which, along with their affiliates, originated 500 or fewer first lien covered transactions in the preceding calendar year. QM status is afforded to certain loans held by these creditors in portfolio for at least three years, regardless of whether the creditor operates predominantly in rural or underserved areas. To qualify, the loan must: (1) provide for regular periodic payments of principal and interest that are substantially equal; (2) not contain negative amortization, interest-only, or balloon payment features; (3) have a term that does not exceed 30 years; and (4) meet the points and fees test, discussed below. While the creditor must consider and verify the consumer's DTI ratio or residual income, the 43% DTI ratio limitation does not apply to this QM category, and the creditor is not required to follow the procedures outlined in Appendix Q when calculating the DTI ratio.

Temporary Small Creditor Balloon Loan QM

The fifth QM category will apply for a two year transition period in which creditors with less than $2 billion in total assets (a figure which will be adjusted annually for inflation) which, together with their affiliates, originated 500 or fewer covered transactions secured by a first lien in the preceding calendar year, may originate loans with balloon payments and be afforded QM status. Under this QM category, it does not matter whether the creditor operates predominantly in rural or underserved areas.

To qualify as a QM under this category, the loan must meet the same requirements as outlined for the third QM category above. Namely, the loan may not have negative amortization or interest-only features, the term of the loan may not exceed 30 years, and the points and fees test discussed below must be met. The loan must provide for scheduled payments that are substantially equal, excluding the balloon payment, which would fully amortize the loan over a period of 30 years or less. The interest rate may not increase over the term of the loan, and the loan's term must be at least 5 years. The creditor is required to consider the consumer's DTI ratio or residual income in underwriting the loan, but the 43% DTI ratio requirement does not apply and the calculation procedures outlined in Appendix Q are not required.

The loan may not be subject to a forward commitment at consummation, unless the purchaser also meets the requirements to originate QM loans under this category. The loan will lose its QM status if it is sold, assigned, or otherwise transferred within the first three years after consummation, unless the loan is sold to another creditor which qualifies to make QM loans under this category, transferred as required by supervisory action, or transferred in connection with a merger or acquisition.

This QM category applies to loans consummated on or before January 10, 2016. QM loans originated under this category will retain their QM status after January 10, 2016, as long as all other requirements are met, including the requirement that the creditor retain the loan in portfolio for at least three years. During the two year transition period, CFPB intends to study whether the current regulatory definitions of "rural" and "underserved" should be adjusted, as well as to work with small creditors in transitioning from balloon loans to other product types, such as ARM loans, which may satisfy the requirements of other QM categories.

Points and Fees Test

As mentioned above, a covered transaction may not be considered a QM unless the total points and fees do not exceed the limits outlined in the table below.

Loan Amount	Points and Fees Limit
$100,000 or higher	3% of the "total loan amount"
$60,000 - $99,999.99	$3,000
$20,000 - $59,999.99	5% of the "total loan amount"
$12,500 - $19,999.99	$1,000
Less than $12,500	8% of the "total loan amount"

Each of the dollar amounts will be adjusted annually for inflation. The term "total loan amount" is defined in Regulation Z, and it cannot be assumed that the total loan amount is the same figure as the amount of the note. Six categories of charges are included in the points and fees calculation: (1) all items included in the finance charge (with the exception of interest or time-price differential, mortgage insurance premiums, bona fide third-party charges not retained by the creditor, and bona fide discount points); (2) compensation paid by the creditor to a mortgage broker or a manufactured home retailer; (3) real estate-related fees; (4) premiums for credit insurance, credit property insurance, or other life, accident, health or loss-of-income insurance where the creditor is the beneficiary; (5) the maximum prepayment penalty; and (6) the prepayment penalty paid in a refinance transaction. The final rule issued in January 2013 required compensation paid by a creditor to its loan originator employee to be included in the points and fees test; however, an amending final rule issued in May 2013 removed this requirement.

Legal Standards and Higher-Priced Loan Thresholds

As mentioned above, a legal safe harbor is afforded to QM loans that are not higher-priced, while a rebuttable presumption of compliance is afforded to higher-priced QM loans. For QM loans secured by first liens, separate thresholds are used for determining whether a loan is higher -priced for small creditors and larger creditors, as CFPB recognizes that small creditors often charge higher interest rates and fees than those charged by larger creditors, for reasons including a higher cost of funds. The various thresholds are outlined in the table below. For purposes of the table, a "small creditor" is a creditor with less than $2 billion in total assets which, together with its affiliates, originated 500 or fewer first lien covered transactions in the preceding calendar year. In determining whether a loan is higher-priced, the creditor must compare the APR as of the date the interest rate is set to the APOR for a comparable transaction. To calculate whether a loan is higher-priced, creditors may use the rate-spread calculators and other guidance available online at: www.ffiec.gov/ratespread.

	First Lien	Subordinate Lien
Small Creditor	APR 3.5% or more above APOR	APR 3.5% or more above APOR
Large Creditor	APR 1.5% or more above APOR	APR 3.5% or more above APOR

Limitations on Prepayment Penalties

The final rule prohibits prepayment penalties on covered transactions, with the exception of non-higher-priced QM loans with either fixed or stepped interest rates. In connection with these loans, prepayment penalties may only apply during the first three years following consummation. If the penalty is incurred during the first two years after consummation, the penalty may not exceed 2% of the outstanding loan balance. If it is incurred during the third year following consummation, the penalty may not exceed 1% of the outstanding loan balance.

In addition, a creditor may not offer a consumer a covered transaction which includes a prepayment penalty unless the creditor also offers the consumer an alternative covered transaction without a prepayment penalty. The alternative loan must have the same type of interest rate as the loan with the prepayment penalty, and must have the same loan term. It must provide for regular periodic payments which are substantially equal, it may not include negative amortization, interest-only payments, or a balloon payment, and the points and fees test discussed above must be met. The creditor must have a good faith belief that the consumer likely would qualify for the alternative loan, based on the information known to the creditor at the time the alternative loan is offered.

Record Retention

Creditors are required to retain evidence of compliance with the ability to repay requirements for a minimum of three years following consummation of the loan. For many reasons, creditors may choose to keep such records for a longer period of time. For example, the creditor's compliance with the requirements may be questioned in a compliance exam occurring more than three years after consummation of the loan. Also, while an affirmative claim brought by a consumer must begin within three years of consummation of the loan, the consumer may assert that the creditor failed to comply with the ability to repay requirements as a defense to a foreclosure action.

Creditors are not required to retain hard copies of documentation used in underwriting loans, but must be able to accurately reproduce those records. For example, if a creditor uses a consumer's W-2 form to verify income, the creditor must be able to reproduce the W-2 form, and not merely the information that was contained in the form.

Conclusion

CFPB has issued a final rule requiring that a creditor make a reasonable, good faith determination before consummating a mortgage loan that the consumer has a reasonable ability to repay the loan according to its terms. Creditors may comply with the rule by meeting the general ability to repay standard, which requires consideration and verification of eight specified factors in underwriting the loan. Alternatively, a creditor may originate a "qualified mortgage" by meeting separate requirements, which will provide the creditor with greater legal protection and certainty. The rule creates five categories of qualified mortgages, two of which are temporary in nature. The final rule becomes effective **January 10, 2014**.

CFPB has also issued proposed rules to clarify various provisions of the Ability to Repay/Qualified Mortgage rule, including the use of GSE and federal agency eligibility requirements in determining QM status; the determination of debt and income for purposes of originating QM loans; and which compensation paid to retailers of manufactured homes and their employees is counted within the points and fees test. WBA anticipates that CFPB may issue additional proposed rules to amend and clarify the final rule's requirements prior to the rule's effective date.

Each of the final and proposed rules, the list of counties designated as "rural" or "underserved", and various compliance aids created by CFPB may be found at CFPB's Regulatory Implementation web page: www.consumerfinance.gov/regulatory-implementation/.

To assist members in their compliance efforts, WBA has launched a complimentary call program in partnership with the Boardman & Clark LLP law firm to answer members' questions regarding CFPB's mortgage-related rulemakings. The program is available exclusively to WBA members, and will run through the effective date of the Ability to Repay/ Qualified Mortgage rule. Questions beyond the scope of the program, such as requests to draft documents or confer with a bank's board of directors, would require establishment of a lawyer-client relationship with the firm and would result in fees for the additional service. To take advantage of this program, submit questions to WBA's Jennifer Torbeck at 608-441-1244, Heather MacKinnon at 608-441-1246, or Kris Cleven at 608-441-1263, or by email at wbalegal@wisbank.com. Banks which are already clients of the Boardman & Clark LLP law firm may contact John Knight at 608-283-1764, Gail Perry at 608-283-1787, or Patrick Neuman at 608-283-1774.■

JUDICIAL SPOTLIGHT

Wisconsin Supreme Court Dismisses Guarantor Claims Against Wisconsin Bank

The Wisconsin Supreme Court issued an opinion in *Park Bank v. Roger E. Westburg and Sandra L. Westburg* (2013 WI 57), on July 3, 2013, dismissing several counterclaims and affirmative defenses raised by the guarantors of a loan made by Park Bank, Milwaukee, to a local corporation. The claims and defenses were raised by the guarantors in response to the Bank's efforts to collect the loan from the guarantors. According to the Court, all of the claims made by the guarantors against the Bank except for one were derivative claims of the corporation and therefore could not be brought by the guarantors of the loan against the Bank. The Court acknowledges that the issue of whether a guarantor may raise derivative claims in defense to an action seeking payment under a guaranty had not previously been addressed by Wisconsin courts. The WBA participated in the case before the Wisconsin Supreme Court in support of the Bank's position in the case.

The guarantors alleged claims against the Bank for breach of fiduciary duty, breach of duty of good faith and fair dealing under the contract, negligence, breach of duty to disclose and other claims. According to the Court, these claims belonged to the corporation and were not the individual claims of the guarantors that could be raised in defense to the action by the Bank to collect from the guarantors. Such claims raised on behalf of the corporation are called "derivative claims" under the law, and the Court decided that "a guarantor lacks standing to raise derivative claims". The Court quotes favorably from another court decision stating that "guarantors cannot recover on account of injury done [to] the corporation", and "only where a guarantor suffers direct injury . . . may the guarantor pursue direct remedies". The Court concluded that "a guarantor lacks standing to raise derivative claims." The Court determined that with the exception of the one personal claim of the guarantors that the Bank unlawfully denied them access to their personal account, all of the other claims were derivative. The Court dismissed these claims by the guarantors against the Bank. This decision serves as important judicial precedent in our state.

The Court acknowledged that the guarantors may raise certain derivative claims on behalf of the corporation in their capacity as shareholders of the corporation. The guarantors in this case were also shareholders of the corporation. However, in order for them to maintain a

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Read "Special Focus" for an article regarding recently enacted state legislation. Next, turn to "Regulatory Spotlight" for numerous CFPB items. Then, check "Compliance Notes" for information on updates to several CFPB small entity compliance guides. ■

SPECIAL FOCUS

Summary of Recently Enacted State Legislation.

Notice No. 2013-8

There have been two recently enacted state legislative items which directly impact financial institutions. The following article highlights those items.

Bank Services Corporations: 2013 Wisconsin Act 22
Effective, **07/07/2013**, 2013 Wisconsin Act 22 expands the definition of "bank services" to specifically include auditing, compliance, loan documentation, administrative, and technology functions performed by a bank, as well as any other service established by the Wisconsin Department of Financial Institutions (DFI).

Under current law, two or more banks may organize a corporation to perform bank services (bank service corporation) by investing more than ten percent of each bank's capital in the bank service corporation and holding the capital stock of the bank service corporation. A bank service corporation may perform bank services for banks, but may not engage in any other activity. "Bank services" are defined to mean: check and deposit sorting and posting; computation and posting of interest and other credits and charges; preparation and mailing of checks, statements, notices, and similar items; or any other clerical, bookkeeping, accounting, statistical, or other similar functions performed for a bank. In addition to using a bank service corporation, a bank may contract to have performed for the bank any service if both the bank and the contractor assure DFI that the performance of the service will be subject to regulation and examination by DFI to the same extent as if the service were performed by the bank.

Also under current law, a bank that has not organized a bank service organization (nonparticipant bank) and that is competitive with banks that have organized a bank service corporation may obtain bank services from the bank service corporation by, at the nonparticipant bank's option, either: (1) acquiring an ownership interest in the bank service corporation, or (2) obtaining the bank service at a rate no higher than necessary to fairly reflect the cost of the service, including the cost of capital contributions of the bank service corporation owners. However, the bank service corporation may deny a bank service to the nonparticipant bank if the bank service is available from another source at a competitive cost or if providing the bank service to the nonparticipant bank would be beyond the practical capacity of the bank service corporation.

As mentioned above, 2013 Wisconsin Act 22 expands the definition of "bank services" to specifically include auditing, compliance, loan documentation, administrative, and technology functions performed for a bank, as well as any other service established by DFI. The Act also revised Wisconsin statute 221 to allow DFI to establish additional services as "bank services" if the services are related to the routine daily operations of banks. DFI is not required to engage in rulemaking to establish additional services as "bank services." If a bank files a written request with DFI to establish additional services as "bank services," DFI must approve or disapprove the request within sixty days after receiving the request. The Act also repealed the requirement that a bank service corporation provide bank services to nonparticipant banks. Finally, the Act made similar revisions to Wisconsin statute 186 to allow DFI's Office of Credit Unions to expand the list of permissible services provided by credit union service organizations in a similar manner.

Amendment to UCC Article 4A Relating to EFTA and Remittance Transfers: 2013 Wisconsin Act 33
2013 Wisconsin Act 33 makes technical amendments to Wisconsin's Uniform Commercial Code (UCC) Article 4A, which governs funds transfers, Wisconsin statute 410. Under statute 410, a "funds transfer" is defined as a series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. A "payment order" is defined as an instruction of the sender to a bank to pay, or to cause

another bank to pay, a specified amount of money to the beneficiary of the payment order. UCC Article 4A establishes comprehensive provisions to govern funds transfers, but these provisions do not apply to a funds transfer any part of which is governed by the federal Electronic Fund Transfer Act (EFTA). EFTA is implemented by the Bureau of Consumer Financial Protection's (CFPB's) Regulation E.

Under the requirements of the Dodd-Frank Act which revised EFTA, CFPB has revised Regulation E to implement disclosures and consumer protection rights related to a funds transfer now called a "remittance transfer." As a result of how CFPB implemented these rules, ambiguity arose regarding how EFTA should apply to a remittance transfer when, previous to the creation of the term, these types of funds transfers were typically governed by UCC Article 4A.

Of particular concern are consumer international wire transfers which have traditionally been exempt from EFTA and instead are governed by UCC Article 4A. Senders and receivers of such wire transfers have long established systems and procedures in place which implement UCC Article 4A rules and provisions. For example, senders and receivers have procedures which govern when there has been a mistake in identifying the designated beneficiary. However, under revised EFTA and Regulation E rules, a consumer international wire transfer could meet the definition of remittance transfer and would therefore be subject to EFTA and not UCC Article 4A. Unfortunately, EFTA is not as comprehensive as UCC Article 4A; and without the same level of comprehensive provisions as provided under UCC Article 4A, financial institutions and other transfer providers may be unwilling to offer remittance transfer services to consumers.

To remedy that concern, Wisconsin is one of thirty-nine states which have adopted uniform amendments to UCC Article 4A to address the issues related to remittance transfers. Under 2013 Wisconsin Act 33, provisions of UCC Article 4A, as adopted in Wisconsin statute 410, will apply to a funds transfer that is a remittance transfer as defined under EFTA, unless the remittance transfer is an electronic fund transfer as defined under EFTA. If the provisions of UCC Article 4A apply with respect to a funds transfer and there is an inconsistency between these provisions and EFTA, the provisions of EFTA govern to the extent of the inconsistency. The technical amendment may best be explained by an example as outlined below.

First, a review of key definitions of EFTA for the following example may be helpful. Under EFTA, a "remittance transfer" means an electronic transfer of funds, requested by a consumer, to a recipient in a foreign country, made by the transfer provider in the normal course of its business, but does not include transfers of small value. Under EFTA, "electronic fund transfer" means a transfer of funds initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape that orders, instructs, or authorizes a financial institution to debit or credit an account. "Electronic fund transfer" includes point-of-sale transfers, automated teller machine transactions, direct deposits or withdrawals of funds, and transfers initiated by telephone, but does not include certain transactions such as transactions originated by check; Fedwire transfers; certain automatic transfers between a consumer's savings and checking accounts; and certain nonrecurring transfers initiated by a consumer by telephone.

By way of example, a consumer comes to a financial institution with cash and requests that the institution originate a payment order to electronically transfer the money to a recipient in a foreign country. The electronic transfer is made to the recipient in the foreign country. Because the transfer is not initiated by electronic means from a consumer's account, the transfer is not currently covered by EFTA, as it is not an electronic funds transfer. However, the transfer does meet the definition of "funds transfer" under UCC Article 4A. Wisconsin statute 410 would apply to the funds transfer and those provisions clearly provide rules and remedies which financial institutions and other transfer providers have long worked with when making such a funds transfer.

Beginning **10/28/2013**, when CFPB's remittance transfer rules become effective, that same transaction as outlined above will be a "remittance transfer" and will therefore be subject to EFTA. 2013 Wisconsin Act 33 clarifies that the transaction would be subject to EFTA remittance transfer

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rules because the transaction meets the definition of "remittance transfer" but is not an electronic funds transfer. As a result, the consumer would be afforded all of the disclosures and consumer protections for remittance transfers under EFTA. The revision to Wisconsin statute 410 also means that UCC Article 4A will also apply to the transaction because the transfer is not an electronic funds transfer. This will provide clarity for the financial institutions or other transfer providers because the longstanding comprehensive provisions of UCC Article 4A will continue. Furthermore, to the extent of any inconsistency between EFTA and UCC Article 4A the amendment provides that EFTA provisions will apply. This means that if the consumer were to exercise the right to cancel the remittance transfer and obtain a refund, which is a right under EFTA, the financial institution or other transfer provider would need comply with that right even if Wisconsin statute 410 would have otherwise prevented the cancellation or reversal of the transfer. Financial institutions should review their current funds transfer systems and procedures in light of this amendment and in preparation for the mandatory compliance date for remittance transfers. Similar changes have been made by Board of Governors of the Federal Reserve System to Regulation J, 12 CFR part 210, to ensure the continued applicability of UCC Article 4A to remittance transfers carried through Fedwire, and by Financial Crimes Enforcement Network (FinCEN) to ensure such transfers are still subject to Bank Secrecy Act (BSA) regulations for monitoring and reporting purposes. The UCC Article 4A amendments are effective **07/07/2013**.

For copies of the referenced Wisconsin Acts, contact WBA's Crystal Benes at 608/441-1207 or cbenes@wisbank.com.■

REGULATORY SPOTLIGHT

Agencies Issue Semiannual Regulatory Agendas.

- The Bureau of Consumer Financial Protection (CFPB) has published its semiannual regulatory agenda. CFPB anticipates considering the regulatory matters identified within the agenda between **05/01/2013**, and **05/01/2014**. The agenda includes: (1) preliminary actions regarding revisions to the Home Mortgage Disclosure Act (HDMA) as required by the Dodd-Frank Act (DFA); (2) a final rule regarding integrated mortgage disclosures under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA); (3) a final rule regarding the Expedited Funds Availability Act (Regulation CC); and (4) the development of proposed regulations concerning data collection under the Equal Credit Opportunity Act (ECOA) for business lending data as required under DFA. According to the agenda, the final rule for the integrated RESPA/TILA disclosures is expected sometime in October, and the final rule for Regulation CC is expected sometime in December. The next agenda will be published in the fall of 2013 and will update this agenda through the fall of 2014. The information is current as of **05/10/2013**. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-23/pdf/2013-17076.pdf. *Federal Register*, Vol. 78, No. 141, 07/23/2013, 44350-44354.

- The Board of Governors of the Federal Reserve System (FRB) has published its semiannual regulatory agenda. FRB anticipates considering the regulatory matters identified in the agenda between **05/01/2013**, and **10/31/2013**. The next agenda will be published in the fall of 2013. Comments regarding the form or content of the agenda may be submitted anytime during the next six months. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-23/pdf/2013-17090.pdf. *Federal Register,* Vol. 78, No. 141, 07/23/2013, 44400-44402.

- The Federal Deposit Insurance Corporation (FDIC) has published its semiannual regulatory agenda. The agenda contains information about FDIC's current and projected rulemakings, existing regulations under review, and completed rulemakings. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-23/pdf/2013-17084.pdf. *Federal Register*, Vol. 78, No. 141, 07/23/2013, 44394-44398.

- The Department of the Treasury (Treasury) has published its semiannual regulatory agenda. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-23/pdf/2013-17067.pdf. *Federal Register,* Vol. 78, No. 141, 07/23/2013, 44308-44309.

- The Small Business Administration (SBA) has published its semiannual regulatory agenda, which provides a summary of all current and projected rulemakings and completed actions by SBA. SBA invites comment on any aspect of the agenda. Copies of the agenda may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-23/pdf/2013-17073.pdf. *Federal Register,* Vol. 78, No. 141, 07/23/2013, 44332-44339.

- The Securities and Exchange Commission (SEC) has published its semiannual regulatory agenda. Information in the agenda is accurate as of **06/19/2013**. SEC invites

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Read "Special Focus" for an article regarding new mortgage servicing requirements under Regulation Z. Next, turn to "Regulatory Spotlight" for a final rule by CFPB to modify DFA-related mortgage rules. Then, check "Compliance Notes" for information about FDIC UDAP CMPs and a reminder of the Biggert-Waters Act effective date. ■

SPECIAL FOCUS

Mortgage Servicing Requirements under Regulation Z

Notice 2013-9

On January 17, 2013, the Bureau of Consumer Financial Protection (CFPB) issued two final rules to amend the mortgage loan servicing requirements under Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA) and Regulation Z, which implements the Truth in Lending Act (TILA). CFPB also issued subsequent final rules on July 10, 2013 and September 13, 2013 to further amend the servicing requirements. This article is intended to provide an overview of the new requirements under Regulation Z. The October 2013 edition of *WBA Compliance Journal* will feature an article on the servicing requirements under Regulation X. All of the new servicing requirements will become effective **January 10, 2014**.

Scope of Regulation Z Requirements

The new requirements under Regulation Z apply to a "mortgage loan", which is defined by Regulation Z as a closed-end consumer credit transaction secured by a dwelling. The definition excludes open-end lines of credit, reverse mortgage transactions, and transactions secured by consumers' interests in timeshare plans.

Servicers will be required to provide periodic statements to consumers regarding their mortgage loans, provide interest rate adjustment notices in connection with adjustable rate mortgage loans (ARMs), promptly credit payments to mortgage loans, and provide payoff statements upon request.

Small Servicer Exemption under Regulation Z

The final rule provides an exemption from several of the servicing requirements for a "small servicer." A small servicer is one who, together with its affiliates, services 5,000 or fewer mortgage loans, for all of which the servicer or an affiliate is either the creditor or assignee. In order to be the creditor or assignee, the servicer or its affiliate must either currently own the mortgage loan or have been the entity to which the mortgage loan was initially payable, i.e. the originator. In the case of a merger or acquisition, the servicer is considered the creditor or assignee of mortgage loans obtained through the merger or acquisition.

Loans which do not meet the definition of "mortgage loan" for purposes of the servicing requirements are not considered for the purpose of determining small servicer eligibility. In addition, mortgage loans voluntarily serviced for a creditor or assignee that is not an affiliate of the servicer, and for which the servicer does not receive any compensation or fees, are not considered. Such loans are not considered in determining whether the servicer services 5,000 or fewer mortgage loans, or whether the servicer services mortgage loans it does not own or did not originate. The Official Commentary to Regulation Z provides examples which demonstrate when a servicer is ineligible for the small servicer exemption due to failure to meet both requirements.

To determine whether a servicer meets the criteria for the small servicer exemption, the evaluation is based on mortgage loans serviced by the servicer and any affiliates as of January 1. If the servicer services any mortgage loans the servicer or its affiliate did not originate or does not own, the servicer is ineligible for the exemption, even if the number of mortgage loans serviced is 5,000 or less. If a servicer ceases to qualify for the exemption, the servicer is afforded six months or until the next January 1, whichever is later, to comply with the servicing requirements from which the servicer was previously exempt. The Official Commentary to Regulation Z provides examples to illustrate the timing requirement for compliance.

When a loan is subserviced, both the master servicer and subservicer must meet the small servicer criteria for the subservicer to qualify for the small servicer exemption. A subservicer generally will not qualify for the small servicer

exemption, as the subservicer often services mortgage loans it does not own or did not originate. If the subservicer is the affiliate of a master servicer which qualifies as a small servicer, it is possible that the subservicer may also qualify as a small servicer due to the affiliate relationship. If the subservicer does not qualify as a small servicer, the master servicer may still be eligible for the small servicer exemption for the loans it services in-house.

Several WBA members have expressed concern regarding the master servicer and subservicer provisions within the small servicer exemption, principally in connection with loans serviced through the Federal Home Loan Bank's (FHLB) Mortgage Partnership Finance (MPF) program. Servicing contracts entered into with FHLB may identify a master servicer and a subservicer, but these terms do not necessarily share the definitions provided in the final rule. FHLB has issued an advisory that confirms that the terms used in the MPF program contract do not necessarily dictate whether a servicer is eligible for the small servicer exemption. The advisory may be found at: http://www.fhlbmpf.com/docs/advisories/2013/PFI_Advisory_091013.pdf. Regardless of the terms used in the FHLB contract, or in any other master servicer and subservicer agreement, servicers should complete a separate analysis of whether the conditions for the small servicer exemption are met by reviewing the rights and authorities servicers have under their agreement with the definitions provided in the final rule.

Small servicers are exempt from the Regulation Z requirement to provide periodic statements. Small servicers are also exempt from several, but not all, of the servicing requirements under Regulation X, including certain requirements regarding force-placed insurance, the general requirements regarding servicing policies and procedures, and several of the requirements regarding communications with borrowers about loss mitigation options. Regardless of small servicer status, all servicers must comply with the Regulation Z ARM disclosure provisions and prompt crediting and payoff statement requirements, as well as several of the force-placed insurance provisions, error resolution and information request provisions, and some of the loss mitigation provisions required by Regulation X.

Periodic Statements

The servicer of a mortgage loan must provide the consumer with a periodic statement for each billing cycle, showing information on the payment due and the application of past payments, among other items. The requirement does not apply to loans which do not fit the definition of "mortgage loan", particularly reverse mortgage transactions and transactions secured by consumers' interests in timeshare plans. The requirement also does not apply to loans for which a coupon book is provided, if certain requirements discussed below are met; or mortgage loans serviced by small servicers.

Creditors, assignees, and servicers each have a responsibility for compliance with the periodic statement requirements. However, each party is not required to send a separate periodic statement; the consumer must receive only one statement each billing cycle. Creditors or assignees that do not currently own the mortgage loan or the servicing rights are not subject to the requirement to provide a periodic statement.

Content and Format Requirements

The information in the periodic statement must be delivered in a manner that is clear and conspicuous, which generally requires the disclosures to be presented in a reasonably understandable form. The final rule requires information to be provided in certain groupings, and specifies areas of the periodic statement where several of the groupings must appear. The groupings may be created by presenting the information in boxes or arranging the items in groups with spaces between the groups. Items in close proximity may not have any intervening text between them. Sample forms are provided in Appendix H to Regulation Z.

There are eight required groupings of information: (1) amount due; (2) explanation of amount due; (3) past payment breakdown; (4) transaction activity; (5) partial payment information; (6) contact information; (7) account information; and (8) delinquency information.

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Grouping	Required Information	Location on Periodic Statement
Amount Due	• Payment due date • Amount of late fee if payment is late • Amount due	Top of the first page
Explanation of Amount Due	• Monthly payment amount • Breakdown of application to principal, interest and escrow • Total of fees imposed • Past amount due	First page
Past Payment Breakdown	• Total of all payments since last statement • Application of payments since last statement to principal, interest, escrow, fees, and suspense account • Total of all payments since beginning of calendar year • Application of all payments since beginning of calendar year to principal, interest, escrow, fees, and suspense account	First page
Transaction Activity	• All transaction activity since last periodic statement	Anywhere on periodic statement
Partial Payment Information	• If funds are held in suspense account, information on what action consumer must take for funds to be applied to loan	Anywhere on periodic statement, or in a separate letter
Contact Information	• Toll-free telephone number and email address, if applicable, where consumer may obtain information about mortgage loan	First page
Account Information	• Outstanding principal balance • Current interest rate • Date when interest rate may change • Existence of any prepayment penalty • Housing counselor information	Anywhere on periodic statement (No grouping requirement)
Delinquency Information	• Date consumer became delinquent • Notice of risks and expenses if delinquency is not cured • Account history of past 6 months or period since last time account was current (whichever is shorter), which shows amount remaining past due for each billing cycle • Notice showing any loss mitigation program consumer has agreed to, if applicable • Notice that servicer has made first notice or filing required to start foreclose, if applicable • Total payment to bring account current • Reference to homeownership counseling information provided elsewhere on statement	Anywhere on periodic statement, or in a separate letter (include only if consumer if 45 days or more delinquent on the loan)

The servicer may choose to include additional information within the periodic statement that is not otherwise required, such as information on the consumer's escrow account, provided that the information does not overwhelm or obscure the required disclosures. The periodic statement may also be combined with statements for other accounts, such as a checking account, so long as the servicer meets all of the requirements for the periodic statement, and combining the statements is not prohibited by any regulation which governs the other account.

If an item is not applicable to the loan, the servicer is not required to include such information on the periodic statement. For example, if the servicer does not charge a prepayment penalty, information on a prepayment penalty is not required to be included on the periodic statement.

Timing and Delivery Requirements

A periodic statement must be sent to the consumer each billing cycle, which corresponds to the frequency of payments. For example, if a loan requires the consumer to make monthly payments, the loan has a monthly billing cycle. Similarly, a loan with required quarterly payments has a quarterly billing cycle.

Periodic statements need not be sent more frequently than once per month. If the billing cycle for a mortgage loan is shorter than 31 days, such as biweekly, it is permissible for a periodic statement for the loan to cover an entire month. Information from more than one billing cycle may be combined in a single periodic statement to create the explanation of the amount due or the past payment breakdown.

The periodic statement must be mailed or delivered within a "reasonably prompt" time after the payment due date or the end of any courtesy period provided for the previous billing cycle. The Official Commentary to Regulation Z provides that "reasonably prompt" generally means delivering, emailing, or mailing the periodic statement within four days of the close of the courtesy period of the previous billing cycle. "Courtesy period" is defined as a period following the due date in which the creditor does not impose a late fee. If there is no courtesy period, the periodic statement must be sent no later than four days after the payment due date.

Periodic statements may be provided in person or by mail. If the consumer provides affirmative consent, periodic statements may be delivered electronically, provided they are in a form the consumer can print or download. Alternatively, the servicer may send a link to an online site where consumers may securely access their statements. If the servicer currently sends the consumer electronic disclosures for any account, such as a checking account, the servicer is not required to seek affirmative consent for the mortgage loan periodic statements. A consumer may not choose to opt out of receiving periodic statements. However, if the consumer chooses to receive statements electronically, the consumer may opt out of electronic notifications that statements are ready to be accessed online once they have demonstrated the ability to access statements online as discussed in the commentary to section 1026.41 of Regulation Z.

The periodic statement requirements no longer apply when a loan is transferred to another servicer, a loan is fully paid or is paid off through a refinance or sale of the property, or when a loan is discharged in a foreclosure sale. Periodic statements must be sent when a consumer is delinquent or in bankruptcy.

Coupon Books

In lieu of providing periodic statements, a servicer may provide a coupon book to the consumer which contains certain information. The servicer may choose to provide a coupon book, and not periodic statements, only for fixed-rate loans. Periodic statements must be sent to all consumers who have ARMs, even if a coupon book is also provided. Certain information must be provided in the coupon book. Every coupon must include: (1) the payment due date; (2) the amount of any late payment fee and the date on which a late fee will be charged if payment is not received; and (3) the amount due. The coupon book must include several other items of information, which may be provided on the inside of the front or back cover, or on filler pages: (1) the outstanding principal balance at the beginning of the time period covered by the coupon book; (2) the current interest rate; (3) the existence of any prepayment penalty; (4) HUD's toll-free telephone number (800-569-4287) to access contact information for homeownership counselors or counseling organizations, and the website address for either the CFPB information page on homeownership counselors or HUD's list of homeownership counselors and counseling organizations; and (5) contact information for where consumers can get more information about their loans.

In addition, certain information must be made available to the consumer upon request. The servicer must provide: (1) an explanation of the amount due, including the periodic payment amount, as well as a breakdown of how the periodic payment is applied to principal, interest and escrow; (2) the total fees or charges imposed since the last periodic statement; and (3) any payment amount past due. The servicer must also provide, upon request, a breakdown of past payments, including the: (1) total of all payments received since the previous periodic statement; (2) amount, if any, applied to principal, interest, escrow, fees and charges, along with the amount, if any, sent to a suspense account; and (3) total of all payments received since the beginning of the calendar year, including a breakdown showing the amount, if any, applied to principal, interest, escrow, fees and charges, and amount, if any, currently held in a suspense account. The servicer must also provide a list of transaction activity that has occurred since the last periodic statement, as well as the due date, a brief description, and the amount for each transaction on the list. If the servicer is currently holding funds in a suspense account, the servicer must include information explaining what actions the consumer must take for the funds to be applied to the mortgage loan.

For each billing cycle, certain information must be provided in writing to consumers whose loans are 45 days or more delinquent. The servicer must provide the same delinquency information that must be included on the periodic statement for delinquent accounts, as outlined in the above table.

Interest Rate Adjustment Notices

The final rule requires servicers to make disclosures in connection with the initial interest rate reset of an adjustable -rate mortgage (ARM) loan, as well as each time an interest rate adjustment results in a payment change. Model forms provided in the final rule may be used in creating the servicer's own notices, along with sample forms that serve as examples of actual ARM notices.

Scope of Notice Requirement

For purposes of the requirement, an adjustable rate mortgage loan, or ARM, is defined as a closed-end consumer credit transaction secured by a consumer's principal dwelling for which the annual percentage rate (APR) may increase after consummation. The creditor's lien position is irrelevant for purposes of the disclosure requirements. ARMs with terms of one year or less are exempt from the initial and ongoing disclosure requirements. There is no small servicer exemption from the interest rate adjustment notice requirements; all servicers must comply. The ARM disclosure requirements apply to loans originated both before and after the final rule's effective date of **January 10, 2014**.

Similar to the periodic statement requirement, the creditor, assignee and/or servicer of a mortgage loan are each responsible for sending ARM notices. Each party does not need to send a separate notice; the consumer must receive only one notice each time a notice is required. A creditor or assignee that no longer owns a mortgage loan is no longer subject to the requirement to send a notice.

Timing and Format Requirements

The initial interest rate adjustment notice is required only the first time the interest rate adjusts. It must be provided between 210 and 240 days prior to the due date of the first payment at the new interest rate. If the first payment at the adjusted level is due within 210 days of consummation, the disclosure must be provided at consummation. If the adjusted interest rate, or the adjusted payment amount calculated from the adjusted interest rate, is not known as of the date of the disclosure, the servicer may provide an estimate. Such estimates must be based on the calculation of the index as reported within fifteen business days prior to the date of the disclosure, and must be labeled as estimates. The initial interest rate adjustment notice may not be combined with other disclosures; it must be provided as a separate document.

The ongoing interest rate adjustment notices generally must be provided between 60 and 120 days before the first payment at the adjusted level is due. If the servicer provided the initial interest rate adjustment notice at consummation because the first payment at an adjusted level is due within 210 days of consummation, and the new interest rate disclosed in the notice was not an estimate, the servicer is not required to provide a separate ongoing interest rate adjustment notice in connection with that interest rate adjustment, as it has already been accurately disclosed to the consumer. The ongoing interest rate adjustment notice may be provided in the same document as other information, but it must be segregated from other information. The information required to be included in the ongoing interest rate adjustment notice must be provided in the form of a table, and must be substantially similar to the forms provided in Appendix H to Regulation Z.

Special timing requirements apply to the ongoing interest rate adjustment notices provided in connection with certain ARMs. For ARMs with uniformly scheduled interest rate adjustments which occur every 60 days or more frequently, the ongoing interest rate adjustment notice must be provided between 25 and 120 days before the first payment at the adjusted level is due. In addition, for ARMs originated prior to January 1, 2015, for which the loan contract requires the adjusted interest rate and payment to be calculated based on an index figure that is available as of a date that is less than 45 days prior to the adjustment date, the notice must be provided between 25 and 120 days before the first payment at the adjusted level is due. If the first interest rate adjustment occurs within 60 days of consummation, and the initial interest rate adjustment notice provided at consummation included an estimated adjusted interest rate, the ongoing interest rate adjustment notice must be provided as soon as practicable, but not less than 25 days before the first payment at the adjusted level is due.

As previously discussed, the ARM disclosure requirements apply to loans originated both before and after the final rules' effective date of January 10, 2014. A servicer is not required to provide the initial interest rate adjustment notice when the first payment at the adjusted level is due 209 or fewer days from the effective date. However, payments due 210 days or more after the effective date are subject to the rule. The servicer is also not required to provide the ongoing interest rate adjustment notice when the first payment at the adjusted level is due between 25 and 59 days from the effective date. The final rule has also eliminated the current requirement to provide an annual notice to the consumer, even if there is no change in the payment amount.

Content Requirements

The content requirements for the initial and ongoing interest rate adjustment notices are similar, but several additional items must be included on the initial notice, as outlined below.

	Initial Interest Rate Adjustment Notice	Ongoing Interest Rate Adjustment Notices
Date of disclosure	X	
Explanation that the time period for the current interest rate is ending, and that any change in interest rate may result in payment change.	X	X
Effective date of rate adjustment and when future adjustments will occur	X	X
Other changes to loan terms taking effect on date of adjustment	X	X
Current and new interest rates and payment amounts, and due date of first payment at new rate	X	X
For interest-only or negatively amortizing payments, the amount of the current and new payment allocated to principal, interest & escrow, as applicable	X	X
Explanation of how interest rate is determined	X	X
Any limits on rate or payment increases at each rate adjustment and over the life of the loan, as applicable	X	X
Explanation of how the new payment amount is determined, including index or formula used, the loan balance expected on the date of the adjustment, and length of remaining loan term expected on the date of adjustment	X	X
Statement that new payment will not be allocated to principal and will not reduce loan balance, and the payment amount necessary to fully amortize balance over remaining loan term, as applicable	X	X
Prepayment penalty conditions	X	X
Phone number of creditor, assignee, or servicer	X	
Alternatives to making payments at the adjusted interest rate	X	
Website to access HUD or CFPB list of approved homeownership counselors	X	

Prompt Crediting of Payments and Payoff Statements

Periodic payments must be promptly credited to the loan as of the day of receipt, except when a delay in crediting does not result in any charge to the consumer, or in reporting negative information to a consumer reporting agency. For purposes of this requirement, a periodic payment consists of the amount necessary to cover principal, interest and escrow, if applicable. A payment may qualify as a periodic payment, for purposes of this requirement, even if it does not include amounts required to cover late fees, other fees, or non-escrow payments advanced by the servicer on a consumer's behalf. The prompt crediting requirements apply to both open and closed-end loans secured by the consumer's principal dwelling. There is no small servicer exemption from this requirement; all mortgage loan servicers must comply.

The servicer may specify requirements that consumers must follow in making payments, provided such requirements are reasonable, and specified in advance and in writing. As a general rule, a servicer may not impose requirements which make it difficult for most consumers to make conforming payments, and may not require consumers to make payments solely by preauthorized electronic funds transfer (EFT). Regulation Z and its commentary provide a number of examples of reasonable payment requirements for both open and closed-end credit. If a servicer does not notify consumers of payment requirements, consumers must be allowed to make payments by cash, money order, draft, or similar instrument in properly negotiable form during regular business hours at any location where the servicer conducts business, or by EFT, if the servicer has agreed to accept electronic payments from the consumer.

If a servicer notifies a consumer of its requirements for payments and subsequently accepts a payment that does not conform to those requirements, the servicer must credit the payment as of five days after receipt. Partial payments held in a suspense account are not considered "accepted" by the servicer for purposes of the prompt crediting requirement; the prompt crediting requirements do not apply to partial payments.

If a payment less than the amount due is received, the servicer may place the funds in a suspense account. When the amount in the suspense account is sufficient to cover a periodic payment, the funds must be treated as a periodic payment and be promptly credited to the consumer's account. Alternatively, the servicer may credit partial payments to the loan account upon receipt, or return partial payments to the consumer. If funds are held in a suspense account, this fact must be disclosed on the periodic statement provided to the consumer.

Upon receiving a written request from a consumer for payoff information on a mortgage loan, creditors, assignees, and servicers must provide an accurate payoff balance within seven business days. When a creditor, assignee, or servicer is unable to provide the payoff statement within seven business days because the loan is in bankruptcy or foreclosure, or because of natural disasters or other similar circumstances, the payoff statement must be provided within a reasonable time. The payoff statement requirements apply to both open and closed-end loans secured by a dwelling, and are not limited to loans secured by principal dwellings. There is no small servicer exemption; all mortgage loan servicers must comply.

Implementation Tips from CFPB

Within the Small Entity Compliance Guide issued by CFPB on the new servicing requirements, there is a section outlining practical implementation and compliance considerations. When developing a compliance plan, servicers should identify affected products, departments and staff, as well as any changes to the servicer's business process, operations, and technology that may be necessary to facilitate compliance. Servicers should also identify impacts the new requirements may have on service providers or business partners, if any, as software providers or other vendors and business partners may offer compliance solutions that may assist the servicer in complying with the new rules. Servicers should consider the necessary training for servicing, compliance, loss mitigation, collections, and quality control staff. Finally, each servicer's compliance plan should take into account the Dodd-Frank Act-related mortgage rules in addition to the servicing rules, as many of the mortgage rules intersect with each other.

Conclusion

Among the various mortgage reform rules issued by CFPB are new requirements for servicing mortgage loans under Regulation Z. Effective **January 10, 2014**, servicers of mortgage loans will be required to provide periodic statements that comply with content, formatting and timing requirements; provide both initial and ongoing interest rate adjustment notices for ARMs; promptly credit periodic payments; and promptly provide payoff information upon a consumer's request. Additional servicing requirements have been created under Regulation X, which will be discussed in the October edition of *WBA Compliance Journal.*

The final rules issued by CFPB to amend the servicing requirements may be found at: http://www.gpo.gov/fdsys/pkg/FR-2013-02-14/pdf/2013-01241.pdf, http://www.gpo.gov/fdsys/pkg/FR-2013-07-24/pdf/2013-16962.pdf, and http://files.consumerfinance.gov/f/201309_cfpb_titlexiv_updates.pdf. In addition, the Small Entity Compliance Guide issued by CFPB which discusses the servicing requirements may be found at: http://files.consumerfinance.gov/f/201307_cfpb_updated-sticker_servicing-implementation-guide.pdf. ■

REGULATORY SPOTLIGHT

Agencies Issue Proposed Rule on BHC Leverage Ratio Standards.

The Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) seek comment on a proposed rule on leverage ratio standards for U.S. top-tier bank holding companies (BHCs) with at least $700 billion in total consolidated assets or at least $10 trillion in assets under custody, and any insured depository institution (IDI) subsidiary of such BHCs. The proposed rule would establish a "well capitalized" threshold of six percent for the supplementary leverage ratio for any IDI that is a subsidiary of a covered BHC. The proposed rule would also establish a new leverage buffer for covered BHCs above the minimum supplementary leverage ratio requirement of 3 percent. The proposal would take effect beginning **01/01/2018**. Comments are due **10/21/2013**. Copies of the proposed rule may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-08-20/pdf/2013-20143.pdf. *Federal Register,* Vol. 78, No. 161, 08/20/2013, 51101-51115.

Agencies Revise Proposed Rule on Credit Risk Retention and Qualified Residential Mortgages.

The Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Federal

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Read "Special Focus" for an article regarding new mortgage servicing requirements under Regulation X, RESPA. Next, turn to "Regulatory Spotlight" for an interim final rule by CFPB to once again amend the 2013 RESPA and TILA mortgage rules. Then, check "Compliance Notes" for a FDIC Chicago Bulletin regarding acquiring credit-impaired loan portfolios.■

SPECIAL FOCUS

Mortgage Servicing Requirements under Regulation X

Notice 2013-10

In January 2013, the Consumer Financial Protection Bureau (CFPB) issued two final rules to amend the servicing requirements for mortgage loans as imposed by Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA) and Regulation Z, which implements the Truth in Lending Act (TILA). CFPB also issued subsequent final rules in July and September 2013 to further amend the servicing requirements. The October 2013 edition of *WBA Compliance Journal* featured an article on the requirements imposed by amended Regulation Z. This article provides an overview of the requirements imposed under amended Regulation X, which become effective **January 10, 2014**.

Scope of Regulation X Requirements

The servicing requirements under Regulation X place limitations on the force-placement of hazard insurance, dictate procedures for handling notices of error and information requests, mandate the adoption of policies and procedures reasonably designed to achieve specified objectives, require early intervention and continuity of contact with delinquent borrowers, and specify regimented procedures for evaluating loss mitigation applications submitted by borrowers.

Small Servicer Exemption

The final rule provides an exemption from several servicing requirements for those servicers that qualify as a "small servicer." The exemption applies to a servicer who, together with its affiliates, services 5,000 or fewer mortgage loans, for all of which the servicer or its affiliate is either the creditor or assignee (i.e. the originator).

Small servicers are exempt from several, but not all, of the servicing requirements. The Regulation Z requirement to provide periodic statements does not apply to small servicers. Additionally, several of the Regulation X requirements do not apply to small servicers, including: certain provisions regarding force-placed insurance, the general requirements regarding servicing policies and procedures, and many of the requirements regarding communications with borrowers about loss mitigation options. Regardless of small servicer status, all servicers must comply with the adjustable rate mortgage (ARM) disclosure provisions and prompt crediting and payoff statement requirements under Regulation Z, as well as several of the force-placed insurance provisions, error resolution and information request provisions, and some of the loss mitigation provisions under Regulation X.

Force-Placed Hazard Insurance

The final rule places restrictions on the force-placement of hazard insurance. For purposes of these requirements, force-placed insurance is hazard insurance the servicer obtains on behalf of the owner or assignee. "Force-placed insurance", for the purposes of the final rule, does not include flood insurance required because the property is in a special flood hazard zone. It also does not include hazard insurance the consumer obtains and the servicer renews using escrowed funds, or by advancing the servicer's own funds at the servicer's discretion if the consumer agrees to the advance. The force-placement provisions apply to federally related mortgage loans, and do not apply to open-end lines of credit. There is a limited exemption to the prohibition on the purchase of force-placed insurance for consumers with escrow accounts in certain circumstances, as discussed below.

Force-Placement Notices

In order to force-place a hazard insurance policy, the servicer must have a reasonable basis to believe that a consumer has failed to maintain required hazard insurance. Prior to force-placing a hazard insurance policy, the servicer must send two notices to the consumer, and must not have

received evidence that the consumer has continuously had required hazard insurance in place. The first notice must be sent at least 45 days before the servicer charges the consumer for force-placed insurance. A reminder notice must be sent at least 30 days after the first notice was sent. If the servicer does not receive evidence that the consumer has had required hazard insurance in place after the second notice, a force-placed insurance fee may be assessed 15 days or more after the second notice was sent.

The servicer must cancel a force-placed insurance policy within 15 days of receiving evidence that the consumer has required hazard insurance in place, and must refund to the consumer any fees or charges imposed for periods of overlapping coverage. Force-placed insurance charges imposed by a servicer on a borrower, beyond those subject to state regulation as insurance charges, must be bona fide and reasonable.

The first notice provided to the consumer must include: (1) the date of the notice: (2) the servicer's name and mailing address; (3) the consumer's name and mailing address; (4) a request for consumer to provide hazard insurance information for the property; (5) a statement that hazard insurance has expired (or is expiring) and that the servicer does not have evidence of further insurance; (6) a statement that hazard insurance is required and the servicer has purchased or will purchase insurance at the consumer's expense; (7) a statement requesting that the consumer promptly provide the servicer with insurance information; (8) a description of the requested insurance information and how the consumer may provide such information; (9) a statement that the insurance the servicer will purchase or has purchased: (i) may cost significantly more and (ii) may not provide as much coverage as hazard insurance purchased by the consumer; (10) the servicer's telephone number for consumer inquiries; and (11) if applicable, a statement advising the consumer to review additional information provided in the same transmittal.

The reminder notice must contain all of the information contained in the first notice, and must also include: (1) a statement that it is the second and final notice, and (2) the cost of the force-placed insurance, stated as an annual premium. If the servicer does not know the cost, a reasonable estimate may be provided. If the consumer sent insurance information to the servicer that was incomplete, the notice must include a statement that the information is incomplete and that the consumer must send the missing information to avoid a charge for any period for which the servicer is unable to verify hazard insurance coverage.

Force-Placed Insurance Renewal Notices

Before each anniversary of the purchase of a force-placed insurance policy, the servicer must provide the consumer a written notice explaining the renewal and requesting that the consumer provide evidence of having purchased hazard insurance for the property. The written renewal notice must only be provided once per year, and generally must be delivered or mailed at least 45 days before the servicer assesses a charge or fee related to the renewal. The renewal notice must contain generally the same information as the reminder notice that is required before an insurance policy may be force placed.

Confirmation of Consumer's Hazard Insurance Coverage

To confirm that a consumer has maintained continuous hazard insurance coverage, the servicer may request a copy of the consumer's hazard insurance policy declaration page, insurance certificate, or insurance policy or similar forms of written confirmation of insurance. The servicer may reject evidence of hazard insurance coverage submitted by the consumer if neither the consumer's insurance provider nor insurance agent provides confirmation of the information submitted by the consumer, or if the terms and conditions of the consumer's hazard insurance policy do not comply with the requirements of the consumer's loan contract.

As mentioned above, if a consumer sends evidence of having hazard insurance coverage in place that satisfies the requirements of the loan contract, within 15 days the servicer must cancel any force-placed insurance that was purchased for the consumer, refund to the consumer all force-placed insurance premium charges and related fees for any period of overlapping insurance coverage, and remove from the consumer's account all force-placed insurance charges and related fees for the overlapping period.

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Force-Placed Insurance and Escrow Accounts

If a consumer has an escrow account for the payment of hazard insurance, the mortgage loan servicer may not obtain force-placed insurance unless the servicer is unable to maintain the consumer's existing hazard insurance coverage. A servicer is not unable to maintain the consumer's hazard insurance coverage merely because the consumer's loan is overdue or the escrow account has insufficient funds to pay the premium. In such cases the servicer generally must advance funds through the escrow account to maintain coverage. The final rule allows the servicer to add this cost to the escrow balance or to otherwise seek reimbursement from the consumer.

A servicer is considered unable to maintain the consumer's hazard insurance, and may in turn obtain force-placed hazard insurance, if the servicer has a reasonable basis to believe that the hazard insurance provider has cancelled the policy for reasons other than non-payment or that the property is vacant.

A small servicer may purchase force-placed insurance for a consumer with an escrow account whose mortgage loan is more than 30 days overdue if the cost to the consumer for the force-placed insurance is less than the amount the small servicer would need to disburse from the consumer's escrow account to pay the consumer's hazard insurance premium.

Error Resolution and Information Requests

The final rule imposes requirements for responding to notices of error or information requests submitted by consumers. The requirements apply to federally related mortgage loans, as defined in Regulation X, and do not apply to open-end lines of credit. Small servicers are not exempt from the error resolution and information request requirements. In addition, notices or error or requests for information submitted more than one year after the date the mortgage loan is discharged are considered untimely and do not trigger the required procedures. Servicers should not rely solely on a consumer's description of a submission as either a notice of error or an information request to determine what requirements apply to the submission. The servicer must instead evaluate whether the notice fulfills the substantive requirements of a notice of error, an information request, or both.

Upon receiving a written request from a consumer asking the servicer to resolve an error or to send information about an account, the servicer must acknowledge the request or notice of error within five days. Within 30 to 45 days of receiving a notice of error, the servicer must correct the error and provide the consumer written notice of the correction, or conduct an investigation and provide the consumer written notice that no error occurred. Within 30 to 45 days of receiving a request for information, the servicer must provide the requested information or conduct a reasonable search for the information and provide the consumer with written notice explaining why the information is not available. The time periods provided within the error resolution and information request requirements do not include federal legal holidays, Saturdays, or Sundays.

Error Resolution

A notice of error is generally any written notice from a consumer that asserts a specified error and includes the consumer's name, information that enables the servicer to identify the consumer's mortgage loan account, and a description of the error the consumer believes has occurred. A notice on a payment coupon or another payment form is not considered a notice of error. A qualified written request that asserts an error relating to the servicing of a mortgage loan is considered a notice of error.

The error resolution requirements apply to the following categories of asserted errors: (1) failure to accept a payment that conforms to any written requirements specified by the servicer; (2) failure to apply an accepted payment to principal, interest, escrow, or other charges under the terms of the mortgage loan and applicable law; (3) failure to credit a payment to a consumer's mortgage loan account as of the date of receipt; (4) failure to pay taxes, insurance premiums, or other charges in a timely manner as required by the escrow provisions, or to refund an escrow account balance as required; (5) imposition of a fee or charge that the servicer lacks a reasonable basis to impose; (6) failure to provide an accurate payoff balance amount within seven days of a consumer's request; (7) failure to provide accurate information to a consumer regarding loss mitigation options and foreclosure; (8) failure to transfer accurately and timely information relating to the servicing of a consumer's mortgage loan account to a transferee servicer; (9) making the first notice or filing required by applicable law for any judicial or non-judicial foreclosure process in violation of the loss mitigation procedures; (10) moving for foreclosure judgment or order of sale, or conducting a foreclosure sale in violation of the loss mitigation procedures; and (11) any other error relating to the servicing of a consumer's mortgage loan.

Servicers are not required to acknowledge or follow the response requirements for errors that are outside the scope of the above list, although servicers may choose to do so. The requirements do not apply to an error related to the origination of a mortgage loan, the underwriting of a mortgage loan, the subsequent sale or securitization of a mortgage loan, or a determination to sell, assign, or transfer the servicing of a mortgage loan.

<u>Timing Requirements</u>

As previously mentioned, within five days of receiving a notice of error, the servicer must provide a written acknowledgement of the notice. No later than 30 days after receipt, the servicer must either correct the error and provide notice to the consumer explaining the correction made, the effective date of the correction, and contact information for

further assistance, or must conduct a reasonable investigation and notify the consumer that no error occurred. If a consumer requests the documents the servicer relied upon to determine that no error occurred, the servicer must respond to this request within 15 days, and must provide only the documents that were actually relied upon to determine that no error occurred. If a servicer corrects an error and notifies the consumer of the correction in writing within 5 days of receiving the notice of error, the servicer is not required to send a separate acknowledgement of the notice of error.

If a consumer sends a notice alleging multiple errors, the servicer may provide one response or multiple responses. If during the course of investigation the servicer discovers additional errors, the servicer must correct those errors and provide the consumer a written notice of the corrections.

A servicer may request supporting documentation from a consumer in connection with the investigation of an asserted error, but may not require the consumer to provide information as a condition of investigating the alleged error. The servicer also may not determine that no error occurred simply because the consumer did not provide the requested information.

Special timing requirements apply to certain notices of errors. If a consumer alleges the servicer failed to provide an accurate payoff balance amount, the servicer must respond no later than seven days after receiving the notice of error. The servicer must either correct the error and inform the consumer of the correction, or conduct an investigation and notify the consumer that no error occurred. If a consumer alleges that a servicer made an improper first foreclosure notice or filing, or an improper motion for foreclosure judgment or order of sale, the servicer must respond to the notice of error prior to the date of the foreclosure sale or within 30 days, whichever is earlier. If a servicer is unable to investigate, correct, or respond to a consumer who asserts such an error within the specified time period, the servicer may be required to cancel or postpone the foreclosure sale. If a notice of error related to a foreclosure proceeding is received seven or fewer days before the foreclosure sale, the servicer is not required to acknowledge or respond to the notice of error. The servicer is required to make a good faith attempt to respond to the consumer, either orally or in writing, and either correct the error or state the reason the servicer determined that no error occurred.

For errors other than those relating to payoff statements or the foreclosure process, a servicer may extend the time period for responding to the notice of error by an additional 15 days if, before the end of the 30-day period after receipt of the notice of error, the servicer notifies the consumer in writing of the extension, as well as the reasons for the extension. If the original notice alleges multiple errors, the servicer may treat each alleged error as a separate notice of error and may extend the time period for responding to those notices for which an extension is permissible.

Information Requests

The final rule imposes requirements which generally apply to any written request by a consumer for information relating to the servicing of a consumer's mortgage loan that includes the name of the consumer, information that enables the servicer to identify the consumer's mortgage loan account, and a statement of the information the consumer is requesting. A request for information does not include a notice on a payment coupon or other payment form, or a request for a payoff balance. A qualified written request that requests information relating to the servicing of the mortgage loan is a request for information subject to the provisions of this rule.

A servicer is not required to provide information that is not available to the servicer. Information is considered unavailable to the servicer if it is not in the servicer's control or possession, or if the servicer cannot retrieve the information in the ordinary course of business through reasonable efforts. Examples of information that can and cannot be retrieved in the ordinary course of business are included within the Official Commentary to Regulation X. If requested information is not available, the servicer must provide a notice stating that the information is not available, and must provide the basis for the determination as well as the servicer's contact information, including a telephone number.

Timing Requirements

The timing requirements vary depending on the information requested by the consumer. In general, the servicer must respond to an information request within 30 days. A servicer may extend the time period by 15 days if the servicer notifies the consumer of the extension and the reasons for the extension within the initial 30-day period. If the request is for the identity, address or other relevant contact information for the owner or assignee of a mortgage loan, the servicer must respond to the request within 10 days. If the servicer provides the requested information - in writing within five days of receiving the request, a separate acknowledgement of the request is not required.

Exceptions to the Notice of Error and Information Request Requirements

In certain situations, the servicer is not required to comply with the error resolution or information request procedures, but must notify the consumer in writing of the determination no later than five days after making the determination. Such circumstances include: (1) duplicative notices of error or information requests; (2) confidential, proprietary, or privileged information; (3) irrelevant information; (4) overbroad or unduly burdensome requests for information; and (5) untimely information requests.

An information request may be overly broad if it involves an unreasonable volume of documents or information, or if a diligent servicer would be unable to respond to the request without exceeding the time limit to respond or incurring costs that would be unreasonable in light of the circumstances. A notice of error may be overbroad if the servicer cannot reasonably determine the specific error that the consumer asserts has occurred. To the extent a servicer may reasonably identify a valid assertion of error in a notice that is otherwise overbroad, the servicer must follow the error resolution requirements with respect to the identified asserted error. The Official Commentary to Regulation X includes examples of error assertions that are overbroad and of other exceptions.

Designated Address for Notices of Error and Information Requests

A servicer may, but is not required to, specify an address to be used for notices of error and requests for information, so long as written notice of the address is provided to consumers. The same address must be used for both notices of error and requests for information. The notice provided to consumers must include a statement that the consumer must use the established address to assert an error or request information. The notice must be clear and conspicuous, in writing, and in a form the consumer can keep. A servicer must include the designated address in any consumer communications that include contact information for consumers seeking assistance.

If the servicer designates an address to be used for notices of error and information requests, the address may be provided in: (1) the written notice which informs the borrower of contact information to be used to assert errors, (2) the written response acknowledging receipt of a borrower's information request; (3) any periodic statement or coupon book; (4) any website maintained by the servicer in connection with the servicing of the loan; and (5) any notice sent under the early intervention procedures for delinquent borrowers which provides the consumer with contact information for assistance.

A servicer may, but need not, establish a process for receiving notices of error and request for information through email, website form, or other online intake method. Any such online intake process must be in addition to, and not in lieu of, any process for receiving notices of error or requests of information by mail.

General Servicing Policies, Procedures and Requirements

The final rule requires servicers to adopt policies and procedures that are reasonably designed to achieve certain objectives, including accessing and providing timely and accurate information, proper evaluation of loss mitigation applications, facilitating the oversight of and compliance by service providers, facilitating the transfer of information during servicing transfers, and informing consumers of the written error resolution and information request procedures. The rule also provides detailed items within each objective which the policies and procedures must be designed to achieve. The final rule also sets standards for record retention and servicing file creation. Servicers are allowed flexibility in their policies and procedures in light of the size, nature and scope of the servicer's operations, including the volume of mortgage loans serviced, credit quality of loans serviced and history of consumer complaints.

The general servicing policy and procedure requirements apply to federally related mortgage loans, and do not apply to open-end lines of credit, reverse mortgage transactions, or loans for which the servicer is a qualified lender under the Farm Credit Act of 1971. Small servicers are exempt from all of the provisions on general servicing policies and procedures.

Document Retention

In addition to requiring policies and procedures designed to achieve general objectives, the final rule imposes a specific requirement for document retention. Servicers must retain records that document actions taken with respect to mortgage loan accounts until one year after the date the servicer discharged the mortgage or transferred the servicing of the mortgage loan. Servicers are not required by the final rule to keep paper copies of such documentation, and may retain the documentation using any method (including computer programs) that accurately reproduces the documents and that ensures that the servicer may easily access the information.

Servicing File

For each mortgage loan serviced, the servicer must maintain several documents using a method that allows the servicer to compile the documents into a servicing file within five days. The required documents include: (1) a schedule of all transactions credited or debited to the mortgage loan account, including escrow and suspense accounts; (2) a copy of the security instrument that establishes the lien securing the mortgage loan; (3) any notes the servicer's personnel have created that reflect communications with the consumer about the mortgage loan account; (4) a report of the data fields the servicer's electronic system creates related to the consumer's mortgage loan account, such as the terms of the consumer's mortgage loan, the occurrence of automated or manual collection calls, loss mitigation evaluation information, owner or assignee information, or any credit reporting history; and (5) copies of documents and information consumers have submitted as part of loss mitigation or error resolution requests.

Servicers must be prepared to comply with the five day servicing file requirement beginning on January 10, 2014. Servicers are not required to comply with this requirement for information created prior to January 10, 2014, but must maintain information about payments made on or after that date. The five day requirement does not provide the

consumer with an independent right to access information in the consumer's mortgage loan servicing file. If a consumer requests a copy of the servicing file, the servicer must provide a copy of information in the file, subject to the general information request requirements.

Early Intervention with Delinquent Consumers

Servicers are required to establish, or make good faith efforts to establish, live contact with delinquent consumers by the 36th day of delinquency. The servicer must promptly inform delinquent consumers of loss mitigation options that may be available. Servicers must also, at a minimum, provide written information about any available loss mitigation options by the 45th day of the consumer's delinquency. The final rule provides model language that servicers may use for the written notice.

These requirements apply to federally related mortgage loans, and do not apply to open-end lines of credit, reverse mortgage transactions, loans for which the servicer is a qualified lender under the Farm Credit Act of 1971, or any loan that is secured by a property that is not the consumer's principal residence. Small servicers are exempt from all of the early intervention requirements.

Live Contact with Delinquent Borrowers

The final rule provides that delinquency begins on the day a payment sufficient to cover principal, interest, and, if applicable, escrow for a given billing cycle is due and unpaid, even if the consumer is afforded a grace period before a late fee is assessed. For example, if a payment is due January 1, and the amount due has not been paid during the 36 day period following January 1, the servicer must make a good faith effort to establish live contact with the consumer no later than February 6. If a consumer makes a full payment before the end of the 36-day period, the servicer is not required to establish live contact with the consumer. A consumer who is performing as agreed under a loss mitigation option designed to bring the consumer current on a previously missed payment is not delinquent for the purposes of the early intervention requirements. Live contact includes calling a consumer or conducting an in-person meeting with a consumer, but does not include leaving a recorded phone message. Servicers may rely on live contact established at the consumer's initiative to satisfy this requirement. Good faith efforts to establish live contact consist of reasonable steps under the circumstances to reach a consumer, and may include calling a consumer on more than one occasion or sending a written or electronic communication encouraging the consumer to establish live contact with the servicer.

A servicer may use reasonable discretion to determine when it is appropriate to provide information about loss mitigation options. For example, if a consumer notifies the servicer of a material adverse change in the consumer's financial circumstances that is likely to cause the consumer to experience long-term delinquency, such as a loss of employment, the servicer may provide loss mitigation information to the consumer.

Written Notice of Loss Mitigation Options

By the 45th day of a consumer's delinquency, the servicer must provide the consumer with a written notice about loss mitigation options, even if such options have been previously discussed with the consumer. Servicers are not required to provide such written notice more than once during any 180 day period. For example, if a payment is due March 1, and is not paid during the 45 days following March 1, the servicer must provide a written notice regarding loss mitigation options by April 15. If the consumer also fails to make the payment that was due April 1 within 45 days of April 1, the servicer is not required to provide the written notice regarding loss mitigation options again during the 180 day period following April 15.

A written notice regarding loss mitigation options must include: (1) a statement encouraging the consumer to contact the servicer; (2) a telephone number for the servicer's personnel assigned to the consumer; (3) the servicer's mailing address; (4) if applicable, a statement providing a brief description of examples of loss mitigation options that may be available; (5) if applicable, either application instructions or a statement informing the consumer how to obtain more information about loss mitigation options; (6) the website to access either the CFPB or HUD list of homeownership counselors or counseling organizations, and the HUD toll-free telephone number to access such counselors or organizations; and (7) any additional information the servicer determines to be helpful. The required statements within the notice must be clear and conspicuous, and the notice may be combined into a single mailing with other notices. Servicers may choose to provide consumers with detailed information and instructions about loss mitigation, such as a list of documents the consumer should gather when contacting the servicer, or an estimate of how quickly loss mitigation applications are typically evaluated. Servicers may also supplement the written notice with a loss mitigation application. Servicers may send a generic list of loss mitigation options typically offered to consumers with a warning that not all consumers may qualify for the listed options.

Continuity of Contact with Delinquent Consumers

Servicers are required to maintain policies and procedures which are reasonably designed to provide delinquent consumers with continuous access to personnel who can assist them with loss mitigation options where applicable. Small servicers are not required to comply with the continuity of contact requirements. Consumers who have refinanced or paid off their loan, brought it current by paying all amounts owed in arrears, and those who have transferred title (for example, though a deed-in-lieu of foreclosure or a short sale) are not delinquent consumers.

Servicers must assign personnel to delinquent consumers by the time the written notice required by the early intervention requirements is sent, and in any event, by the 45th day of the consumers' delinquency. Consumers must be able to reach the assigned personnel by phone; such personnel must be equipped to respond to consumer inquiries and, as applicable, help them pursue loss mitigation options. Personnel must be able to retrieve the complete record of the consumer's payment history and all of the written information the consumer has provided in connection with a loss mitigation application. The servicer may determine whether to designate a single person or a team of personnel to respond to a consumer. Designated personnel must remain available until the consumer has made two consecutive mortgage loan payments without incurring a late charge in accordance with the terms of a permanent loss mitigation agreement or the mortgage loan. If a consumer re-defaults after making two consecutive payments, the requirements apply again and the servicer's personnel must be available to the consumer by the 45th day of the delinquency.

Loss Mitigation Procedures

Upon receipt of a loss mitigation application, the servicer must acknowledge receipt and inform the consumer whether the application is complete. Timely and complete loss mitigation applications must be evaluated within 30 days, and the servicer must inform the consumer whether a loss mitigation option will be offered. The final rule does not require servicers to offer any specific loss mitigation option, or to use any particular criteria to evaluate consumers for loss mitigation. Servicers are, however, required to maintain policies and procedures reasonably designed to achieve the objective of properly evaluating consumers for loss mitigation options. If a loss mitigation option is denied, the servicer must notify the consumer of the reasons for the denial and provide information about any applicable appeal process. Timely appeals submitted by eligible consumers must be evaluated by independent personnel; the person who evaluated the loss mitigation application may not be the person who evaluates the appeal. Servicers must refrain from beginning or completing the foreclosure process in certain circumstances, as set forth below, when a consumer is being evaluated for loss mitigation options.

Small servicers are exempt from the majority of loss mitigation requirements, with two exceptions. No servicer may make the first notice or filing required to foreclose unless the mortgage loan is more than 120 days delinquent. Also, no servicer may move for foreclosure judgment or order of sale, or conduct a foreclosure sale, if a consumer is performing pursuant to the terms of a loss mitigation agreement.

Incomplete Applications for Loss Mitigation

Generally, if a loss mitigation application is determined by the servicer to be incomplete, the servicer must provide a notice to the consumer within five days acknowledging receipt of the application and stating: (1) that the application is incomplete; (2) the additional documents or information the consumer must submit; (3) a reasonable deadline to submit the missing information; and (4) that the consumer should consider contacting servicers of any other mortgage loans secured by the same property to discuss available loss mitigation options. Servicers must exercise reasonable diligence to make an incomplete application complete.

As outlined above, the servicer must determine a reasonable deadline for the borrower to submit the missing information. In determining a reasonable date, the servicer should consider four dates: (1) the date by which any document or information submitted will be considered stale or invalid because of state law requirements applicable to any available loss mitigation option; (2) the date that is the 120th day of delinquency; (3) the date that is 90 days before a scheduled foreclosure sale; and (4) the date that is 38 days before a foreclosure sale. The servicer should select a date that preserves the maximum rights for the borrower, except when such a deadline will not allow the borrower sufficient time to obtain and submit the needed information. CFPB has provided clarification that it is impracticable for a borrower to obtain and submit information within seven days. The servicer must identify a single date as the deadline, and may not refer generally to the four dates outlined above. Servicers may not estimate foreclosure sale dates in other contexts, but such estimation is permitted for the narrow purpose of this provision.

<u>Prohibition of Review of Incomplete Applications for Loss Mitigation Options</u>

Servicers cannot evade the requirement to evaluate complete loss mitigation applications for all available loss mitigation options by evaluating an incomplete application, and must instead seek the needed information. If the servicer has exercised reasonable diligence and the application remains incomplete for a "significant period of time", the servicer may evaluate the incomplete application and offer a loss mitigation option for which the consumer qualifies. Whether a period of time is considered significant will depend on the circumstances. For example, an application remaining incomplete for 15 days may be significant if a foreclosure sale will occur in less than 50 days, but may be insignificant if the consumer is less than 120 days delinquent.

While servicers generally may not review incomplete loss mitigation applications to offer a loss mitigation option, servicers may offer a short-term forbearance to borrowers based on the review of an incomplete application. The

servicer may grant the borrower's request for a waiver of late fees or other short-term relief until the borrower submits all of the information necessary to evaluate the application for long-term loss mitigation options. The final rule describes a payment forbearance program as a loss mitigation option within which the servicer allows the borrower to forego making payments for a period of time not to exceed 6 months. Such programs may be offered when the borrower is having short-term difficulty. The final rule does not prohibit servicers from offering multiple successive short-term forbearance programs. That said, CFPB intends to monitor how temporary forbearances are used after the effective date of the final rule, and if servicers are inappropriately offering sequential forbearances, CFPB may issue another final rule.

The loss mitigation application procedures continue to apply when a servicer offers a short-term forbearance program based on an incomplete loss mitigation application. The servicer is still required to notify the borrower whether the application is complete, identify what additional information is needed, if any, and exercise reasonable diligence to complete the application. If the application is complete, the servicer must evaluate the application for all available loss mitigation options. These requirements are maintained to prevent servicers from inappropriately diverting borrowers into short term forbearance programs without providing the full protections of the amended regulation. If a borrower does not wish to be evaluated for long term loss mitigation options, the borrower can choose to not provide the additional information necessary to complete the application, and the servicer is then not required to conduct a full evaluation for all available loss mitigation options.

Servicers may offer loss mitigation options to consumers who have not yet submitted a loss mitigation application, or to those who have submitted incomplete applications, if the offer is not based on any evaluation of information submitted by the consumer in connection with the incomplete application. For example, a servicer may offer a trial loan modification to all consumers who are 150 days delinquent. The servicer is not required to comply with the loss mitigation procedures with respect to such a program.

Timing Requirements in Connection with Scheduled Foreclosure Sales

If a loss mitigation application is received more than 37 days before a foreclosure sale, the servicer must evaluate the application within 30 days for all available loss mitigation options, and must provide a notice in writing of the servicer's determination. A servicer is not required to comply with the loss mitigation procedures when a consumer submits a loss mitigation application 37 days or less before a foreclosure sale.

If a foreclosure sale has not been scheduled as of the date a complete loss mitigation application is received, the servicer must treat the application as if it were submitted at least 90 days before a foreclosure sale. This timeline remains in effect even if a foreclosure sale is later scheduled. This may require the servicer to delay a foreclosure sale to allow the borrower the specified time to respond to a loss mitigation offer or to appeal a servicer's denial of a loss mitigation option, as applicable.

Loss Mitigation Denials and Appeals

Any decision not to offer a loss mitigation option is a denial. If a servicer maintains four loss mitigation options and offers one option to a consumer, the servicer has denied the consumer the other three loss mitigation options and must notify the consumer of the denials. The notice must state the deadline for accepting or rejecting an offer of a loss mitigation option, in addition to specifying that the borrower may appeal the servicer's determination, the deadline for the appeal, and any requirements for the appeal. The notice may be combined with other denial notices required by law.

The amount of time a consumer is allowed to respond to a loss mitigation offer depends on the proximity of a foreclosure sale. If the application is submitted 90 days or more before a foreclosure sale, the consumer must be afforded 14 days to consider the offer. If the application is submitted 37 to 90 days before a foreclosure sale, the consumer must be given at least seven days to consider the offer. If the consumer provides no response within the applicable time frame, the servicer may deem the offer rejected. If the consumer appeals the servicer's determination, the servicer must extend the deadline for accepting any loss mitigation option offered until 14 days after the notice regarding how the appeal was resolved is provided to the consumer.

The appeal of the servicer's loss mitigation determination must include an independent evaluation. The person who evaluated the borrower's loss mitigation application cannot review the appeal. Supervisors can evaluate appeals of determinations made by employees, if the supervisor was not directly involved in the initial evaluation. Within 30 days of receiving the appeal, the servicer must notify the borrower of the decision. The final rules do not require the servicer to provide any additional appeal.

Foreclosure filings

Servicers are prohibited from making the first filing or notice required to commence the foreclosure process until the borrower is more than 120 days delinquent. Whether a document is the first notice or filing required to commence the foreclosure process is considered on the basis of foreclosure procedure under applicable state law. If the borrower has submitted a complete loss mitigation

application before the foreclosure process has begun, the servicer may not begin the process until: (1) the servicer sends the consumer a notice that the consumer is not eligible for any loss mitigation option, and the consumer has exhausted the appeal process (this may occur because the appeal process is not applicable, the consumer does not request an appeal within the required time period, or the servicer denies the consumer's appeal); (2) the consumer rejects all loss mitigation options offered; or (3) the consumer fails to perform under a loss mitigation agreement. Similarly, if a consumer submits a complete loss mitigation application after the servicer has made the first notice or filing for foreclosure, but more than 37 days before a foreclosure sale, the servicer cannot move for sale or judgment until one of the three specified events occurs.

The prohibition on moving for a foreclosure judgment or order of sale includes making a dispositive motion for foreclosure judgment such as a motion for default judgment, judgment on the pleadings, or summary judgment, which may directly result in a judgment of foreclosure or order of sale. If the servicer has made a dispositive motion and the servicer subsequently receives a complete and timely loss mitigation application, the servicer must take reasonable steps to avoid a ruling on its dispositive motion until the loss mitigation evaluation process has been completed, such as requesting that the court delay consideration of the dispositive motion.

There are two circumstances in which the prohibition on initiating a foreclosure proceeding until after the 120th day of delinquency does not apply: (1) when foreclosure is based on the borrower's violation of a due-on-sale clause; or (2) when the servicer is joining a foreclosure action as a subordinate lienholder. Financial institutions are reminded to work very closely with bank's own legal counsel when working through foreclosure filings and motions.

Implementation Tips from CFPB

Within the Small Entity Compliance Guide issued by CFPB on the new servicing requirements, there is an outline of practical implementation and compliance considerations. When developing a compliance plan, servicers should identify affected products, departments and staff, as well as any changes to the servicer's business process, operations, and technology that may be necessary to facilitate compliance. Servicers should also identify what impacts the new requirements may have on service providers or business partners, if any, as software providers or other vendors and business partners may offer compliance solutions that may assist the servicer in complying with the new rules. Servicers should consider the necessary training for servicing, compliance, loss mitigation, collections, and quality control staff. Finally, each servicer's compliance plan should take into account other Dodd-Frank Act-related mortgage rules in addition to the servicing rules, as many of the mortgage rules intersect with each other.

October 2013 Interim Final Rule

At the time we went to publication, CFPB released an interim final rule to provide greater clarity concerning the mortgage serving rules that take effect in January 2014. The clarifications address: communications with family members after a borrower dies; contact with delinquent borrowers; and treatment of consumers who have filed for bankruptcy or invoked certain protections under the Fair Debt Collection Practices Act.

The interim final rule also clarifies rules issues by CFPB in January to implement Dodd-Frank Act provisions which require consumers to receive housing counseling before taking out a high-cost mortgage. In particular, the interim final rule specifies which federally required disclosure must be used as the basis for counseling for a small subset of closed-end loans that are not subject to Regulation X, RESPA. Comments are due 30 days after publication of the interim final rule in the *Federal Register.* The November 2013 edition of *WBA Compliance Journal* will feature an article on the interim final rule. The interim final rule may be found at: http://files.consumerfinance.gov/f/201310_cfpb_mortgage-servicing_interim.pdf.

Conclusion

Among the various mortgage reform rules issued by CFPB are new requirements for servicing mortgage loans under Regulation X. Effective **January 10, 2014**, servicers of mortgage loans will be subject to; new limitations on the force-placement of hazard insurance; procedures for responding to notices of error and requests for information; adopting policies and procedures reasonably designed to achieve specified objectives; early intervention requirements for delinquent borrowers; and procedures for evaluating loss mitigation applications. Additional servicing requirements have been created under Regulation Z, which were discussed in the September 2013 edition of *WBA Compliance Journal.*

The final rules issued by CFPB to amend the servicing requirements may be found at: http://www.gpo.gov/fdsys/pkg/FR-2013-02-14/pdf/2013-01241.pdf, http://www.gpo.gov/fdsys/pkg/FR-2013-07-24/pdf/2013-16962.pdf; and http://files.consumerfinance.gov/f/201309_cfpb_titlexiv_updates.pdf. In addition, the Small Entity Compliance Guide issued by CFPB which discusses the servicing requirements may be found at: http://files.consumerfinance.gov/f/201307_cfpb_updated-sticker_servicing-implementation-guide.pdf. ■

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Read "Special Focus" for articles regarding new HOEPA/high-cost mortgage requirements and updates on mortgage servicing requirements under Regulations X and Z. Next, turn to "Regulatory Spotlight" for CFPB's final rule on the RESPA/TILA integrated mortgage disclosures and increased dollar thresholds in Regulations Z & M for exempt transactions. Then, check "Compliance Notes" for revised interagency examination procedures for the garnishment of accounts containing federal benefit payments. ■

SPECIAL FOCUS

HOEPA/High-Cost Mortgage Requirements and Certain Other Provisions.

Notice 2013-11

The Home Ownership and Equity Protection Act (HOEPA) was enacted in 1994 as an amendment to the Truth in Lending Act (TILA) to address problems with home equity lending and refinance transactions. These changes were implemented in Section 32 of Regulation Z, which implements TILA. In 2010, the Dodd-Frank Act amended the scope of HOEPA to cover home purchase loans and home equity lines of credit (HELOCs), revised the rate and fee thresholds for HOEPA coverage, added a new coverage test based on prepayment penalties, and prohibited certain loan features. In January 2013, the Consumer Financial Protection Bureau (CFPB) issued a final rule to implement these provisions of the Dodd-Frank Act by amending Regulation Z. Subsequent final rules were issued by CFPB in September and October 2013 to further amend Regulation Z. This article provides a brief overview of the new requirements for loans covered by HOEPA, referred to as "high-cost mortgages", and certain other provisions contained in these rules which may apply to a broader set of mortgage loans. These rules apply to transactions for which the creditor or lender receives an application on or after **January 10, 2014**.

Scope

The HOEPA requirements in effect prior to January 10, 2014 apply to closed-end consumer credit transactions secured by the consumer's principal residence, with the exception of residential mortgage transactions, meaning that the requirements apply to refinance transactions and closed-end home equity loans. The new HOEPA rule expands coverage to include purchase money mortgages and open-end credit plans, including HELOCs, that are secured by a consumer's principal residence. Mortgage loans secured by manufactured housing and other types of personal property, such as recreational vehicles or houseboats, are subject to HOEPA coverage if the dwelling is the consumer's principal residence.

The high-cost mortgage requirements do not apply to loans secured by a second home or vacation home, reverse mortgage loans, certain construction loans, loans originated and directly financed by a Housing Finance Agency, and loans originated under the U.S. Department of Agriculture's Rural Development Section 502 Direct Loan Program.

High-Cost Mortgage Tests

There are three separate tests to determine whether a transaction is a high-cost mortgage, based on the transaction's annual percentage rate (APR), the amount of points and fees paid in connection with the transaction, and the prepayment penalties that may be charged under the loan or credit agreement. If the loan is deemed to be a high-cost mortgage under any one of the three tests, the creditor must comply with the high-cost mortgage requirements in connection with the loan.

Annual Percentage Rate Test

The first test to determine whether a loan is a high-cost mortgage is based on the loan's APR. If the APR, measured as of the date the interest rate for the transaction is set, exceeds the Average Prime Offer Rate (APOR) for a comparable transaction on that date by more than a certain threshold, the loan is a high-cost mortgage. The thresholds used in the APR test are outlined below:

First-lien transactions, generally	6.5%
First-lien transactions of less than $50,000 that are secured by personal property	8.5%
Subordinate lien transactions	8.5%

The APR calculation that is used to determine whether a transaction is a high-cost mortgage is not the same calculation used for purposes of the Truth-in-Lending disclosures. For fixed rate closed-end transactions, the APR is calculated by using the interest rate in effect on the date the interest rate for the transaction is set. For variable rate closed-end transactions based on an index, the greater of the introductory interest rate (if any) or the fully-indexed rate is used. For a variable rate closed-end transaction that is not based on an index, such as a stepped-rate or preferred rate loan, the maximum rate that may apply during the term of the transaction is used.

When originating a HELOC, the APR must be compared to the APOR for the most closely comparable closed-end transaction. If the HELOC has a variable rate, the most closely comparable closed-end transaction is a variable rate transaction with an initial fixed-rate period that lasts approximately as long as the introductory period, if any, on the HELOC. If the HELOC has no initial fixed rate period, the creditor should assume an initial fixed rate period of one year for purposes of determining the most closely comparable closed-end transaction. If the HELOC has a fixed rate, the most closely comparable closed-end transaction will be a fixed rate transaction with the same loan term as the HELOC. If the HELOC has no definite plan length, the creditor should assume a thirty year term for purposes of determining the most closely comparable closed -end transaction.

Points and Fees Test

The second test used to determine whether a loan is a high-cost mortgage is based on the total points and fees paid in connection with the transaction. A loan of $20,000 or more is a high-cost mortgage if the total points and fees exceed five percent of the "total loan amount". A loan of less than $20,000 is a high-cost mortgage if the total points and fees exceed eight percent of the "total loan amount" or $1,000, whichever is less. The term "total loan amount" is defined within Regulation Z, and it cannot be assumed that the "total loan amount" is the same figure as the amount of the note. The threshold amounts of $1,000 and $20,000 are subject to adjustment annually for inflation.

Prior to the Dodd-Frank Act, TILA provided that a mortgage is subject to the restrictions and requirements of HOEPA if the total points and fees "payable by the consumer at or before closing" exceed the threshold amount. However, the Dodd-Frank Act amended the points and fees test to provide in TILA that a mortgage is a high-cost mortgage if the total points and fees "payable in connection with the transaction" exceed newly established thresholds. As a result of these changes, the definition of points and fees includes certain charges not paid by the consumer.

Eight categories of charges are included in the new HOEPA points and fees calculation: (1) all items included in the finance charge (with the exception of interest or time-price differential; certain guaranty or mortgage insurance premiums; bona fide third-party charges not retained by the creditor, loan originator, or an affiliate of either; and bona fide discount points, with limitations as discussed below); (2) certain real estate-related fees, unless the charge is reasonable, the creditor receives no direct or indirect compensation in connection with the charge, and the charge is not paid to an affiliate of the creditor; (3) premiums payable at or before consummation for credit insurance, credit property insurance, or other life, accident, health or loss-of-income insurance where the creditor is the beneficiary, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract; (4) the maximum prepayment penalty; (5) the prepayment penalty to be paid in connection with a refinance of a loan or line of credit that is held or serviced by the creditor or an affiliate; (6) participation fees payable at or before consummation; (7) fees charged to draw on a HELOC (in completing the calculation, the creditor should assume that the consumer will draw on the credit line at least once); and (8) compensation paid by the creditor to a mortgage broker who is not employed by the creditor, or compensation paid by the creditor or consumer to a manufactured home retailer.

If the consumer or creditor directly or indirectly pays compensation to a loan originator, that compensation is also included in the points and fees test. There are a few exceptions to this general rule. Compensation paid by a consumer to a mortgage broker that has already been

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included in the points and fees test, as it is part of the finance charge, is not counted a second time. Compensation paid by a mortgage broker or a creditor to its loan originator employee is not included in points and fees. Similarly, compensation paid by a retailer of manufactured homes to its employee is not included in points and fees. If the creditor is aware that the sales price of a manufactured home includes loan originator compensation, then such compensation must be included in points and fees. The creditor has no obligation to investigate whether the retailer's sales price includes such compensation.

The points and fees test may include amounts paid by third parties in addition to amounts paid by the consumer. A third -party paid charge is included if it is included in the finance charge. Conversely, while a third-party paid charge may be excluded from the finance charge, it may nonetheless be included in the points and fees calculation, such as if the payment is compensation to a loan originator, payment for certain real estate related items, or premiums for certain credit insurance. The creditor may rely on written statements from the consumer or the third party paying for the charge to determine the source and purpose of the charge. Seller's points are excluded from the finance charge and are therefore not included in points and fees. Creditor-paid charges are also excluded from points and fees, other than loan originator compensation paid by the creditor that is required to be included. The Official Commentary to Regulation Z provides examples of when third-party paid charges are and are not included in points and fees.

As mentioned above, subject to limitations, bona fide discount points may be excluded from points and fees. A discount point is "bona fide" if it reduces the interest rate by an amount that reflects established industry practices. If the interest rate before the discount does not exceed the APOR for a comparable transaction by more than one percentage point, up to two discount points may be excluded from points and fees. If the interest rate before the discount does not exceed the APOR for a comparable transaction by more than two discount points, up to one discount point may be excluded. Finally, for transactions secured by personal property, up to one or two discount points may be excluded using the standard outlined above, except that the interest rate before the discount is compared to the average rate for a loan insured under Title I of the National Housing Act[1], rather than to the APOR for a comparable transaction.

Prepayment Penalties Test

The third test to determine whether a transaction is a high-cost mortgage is based on prepayment penalties. If the prepayment penalty that may be imposed in connection with the transaction applies more than 36 months after consummation or account opening, or the prepayment penalty is an amount more than two percent of the amount prepaid, the transaction is a high-cost mortgage. Prepayment penalties are prohibited on high-cost mortgages; therefore, if a transaction that is subject to the high-cost mortgage rule includes a prepayment penalty that exceeds the above thresholds, the transaction would violate Regulation Z. For closed-end loans, a prepayment penalty is generally a charge imposed for paying all or part of a loan's principal before the date on which the principal is due. For a HELOC, a prepayment penalty is generally a charge imposed if the consumer terminates the HELOC prior to the end of its term. If the creditor agrees to pay bona fide third-party charges on behalf of the consumer on the condition that the consumer will not fully prepay a closed-end credit transaction or terminate a HELOC sooner than 36 months after origination, such charges are not considered prepayment penalties.

Disclosure Requirements

The current HOEPA requirement that creditors provide special disclosures to consumers at least three business days prior to consummation of a high-cost mortgage continues to apply under the final rule. The disclosure must: (1) inform the consumer that the loan will not be effective until consummation or account opening; (2) explain the consequences of default; (3) disclose loan terms such as APR, amount borrowed and monthly payment; and (4) for a variable rate loan, explain the maximum monthly payment that may be required under the terms of the loan or credit plan. The disclosure must be provided in writing and in a form the consumer may keep.

Restrictions on Loan Features and Creditor Practices

The final rule places many restrictions on the features of high-cost mortgages. Balloon payments, due-on-demand clauses and fees for generation of payoff statements may only be included in certain circumstances. Other features are prohibited, such as prepayment penalties and fees charged to modify, defer, renew, extend or amend a high-cost mortgage. Late fees are restricted to four percent of the past due payment, and pyramiding of late fees is prohibited. Charges included in points and fees may not be financed, but charges that are excluded from the definition of points and fees may be financed. In addition, creditors may not structure transactions to evade HOEPA coverage, such as by making two loans rather than one in order to avoid the points and fees threshold.

Balloon Payments

Balloon payments are generally banned for high-cost mortgages, but may be included in three circumstances: (1) the payment schedule is adjusted to accommodate the consumer's seasonal or irregular income; (2) the loan is a

[1]At the time of publication, this rate information was not available from CFPB or the HUD website. WBA contacted CFPB on this matter. CFPB informally confirmed that the information was not available and that CFPB has been communicating with HUD about this issue. WBA urged CFPB to issue formal guidance soon concerning rates to be used in the absence of the required Title I average rates.

bridge loan of twelve months or less made to finance the purchase or construction of a new principal dwelling for the consumer; or (3) the loan meets the criteria of either of the two small creditor balloon loan QM categories set forth in CFPB's Ability to Repay/Qualified Mortgage (ATR/QM) rule. For more information on the small creditor balloon loan QM categories, please see the July 2013 edition of *WBA Compliance Journal.*

Due on Demand Clauses

Due-on-demand clauses that allow the creditor to accelerate the loan by terminating the loan in advance of the original maturity date and demanding repayment of the entire outstanding balance are permitted only in three circumstances: (1) the consumer commits fraud or makes a material misrepresentation in connection with the loan or credit agreement; (2) the consumer fails to meet the repayment terms of the loan or credit agreement, resulting in a default; or (3) an action or inaction by the consumer adversely affects the creditor's security for the loan.

Prepayment Penalties

As mentioned above, the prepayment penalty test to determine whether a transaction is a high-cost mortgage also establishes the extent to which prepayment penalties may be imposed on the types of loans that are within the scope of the high-cost mortgage rule. If a loan is a high-cost mortgage, it may not include a prepayment penalty of any amount. For loans subject to the final rule that are not high-cost mortgages, a prepayment penalty may be imposed up to 36 months after consummation and in an amount up to two percent of the amount prepaid.

Existing HOEPA Restrictions Continue to Apply

Regulation Z currently places many restrictions on HOEPA loans, which the final rule does not change. A high-cost mortgage cannot include negative amortization, a payment schedule that consolidates more than two periodic payments and pays them in advance from loan proceeds, an increase in the interest rate after default, or a refund of interest calculated in a manner less favorable to the consumer than the actuarial method, when acceleration occurs as a result of default in payment. In addition, a creditor cannot refinance a high-cost mortgage into another high-cost mortgage within one year of having extended the initial high-cost mortgage, unless the refinancing is in the consumer's interest.

Ability-to-Repay Requirements for High-Cost Mortgages

Under current Regulation Z, creditors are required to determine the consumer's ability to repay a high-cost mortgage prior to consummation or account opening. The requirement continues to apply under the final rule issued by CFPB, but separate requirements apply to closed-end high-cost mortgages and high-cost HELOCs.

Closed-End High-Cost Mortgages

CFPB's ATR/QM final rule creates ability-to-repay requirements for closed-end credit transactions secured by a consumer's dwelling. The same requirements apply to closed-end high-cost mortgages. It is possible for a high-cost mortgage to also be a qualified mortgage, provided the qualified mortgage criteria are met.
The ATR/QM final rule provides thresholds to determine whether a qualified mortgage is considered "high-cost", but this is not the same threshold used under the HOEPA final rule to determine whether a transaction is a "high-cost mortgage". Under the ATR/QM final rule, whether a qualified mortgage is high-cost will affect whether the creditor receives a safe harbor or a rebuttable presumption of compliance with the ability-to-repay requirements. Under the HOEPA final rule, if a transaction is a high-cost mortgage, the disclosure requirements and other various restrictions apply to the transaction.

Open-End High-Cost Home Equity Lines of Credit

The ATR/QM final rule does not apply to open-end credit, so the ability-to-repay requirements outlined in that final rule do not apply to HELOCs. For open-end high-cost mortgages, the consumer's repayment ability will continue to be determined under the existing HOEPA ability-to-repay rules. In general, the creditor must consider the consumer's current and reasonably expected income or assets, as well as the consumer's current obligations, including any mortgage-related obligations such as property taxes, required insurance premiums, and community association fees.

Homeownership Counseling Requirements

The final rule creates three separate requirements relating to homeownership counseling. First, a consumer who obtains a high-cost mortgage loan must receive homeownership counseling before the loan is consummated. Second, homeownership counseling is also required before a negative amortization loan may be made to a first-time borrower. Third, the creditor must provide a list of housing counselors to all applicants for federally-related mortgage loans, whether or not subject to HOEPA.

High-Cost Mortgage Counseling Requirements

Before making a high-cost mortgage loan, the creditor must receive written certification that the consumer has received homeownership counseling on the advisability of the mortgage. The homeownership counselor must be approved by the U.S. Department of Housing and Urban Development (HUD) or a state housing finance authority, if permitted by HUD. The counselor cannot be affiliated with or employed by the creditor, and the creditor cannot steer the consumer to a particular counselor. Counseling does not

need to occur in person, but the consumer may not use a self-study program to satisfy the requirement. A statement that the consumer has received counseling on the advisability of the high-cost mortgage does not require the counselor to have made a determination as to whether the high-cost mortgage is an appropriate transaction for the consumer.

The consumer generally must receive either the good faith estimate for the loan as required by the Real Estate Settlement Procedures Act (RESPA), or the disclosures required for HELOCs under Regulation Z before the homeownership counseling occurs. For the narrow category of high-cost mortgages that are not covered by RESPA nor subject to the HELOC disclosure requirements under Regulation Z (i.e. high-cost closed-end transactions secured by manufactured housing but not by real property), the homeownership counseling must occur after the consumer receives the HOEPA disclosure required by Regulation Z. The HOEPA disclosure is not required to be provided until three business days before consummation of the loan, which could cause timing difficulties with scheduling homeownership counseling. For this reason, CFPB encourages, but does not require, creditors to provide the HOEPA disclosure earlier than three business days before consummation, to facilitate the counseling and timely consummation of the loan. In all cases, counseling may occur after the consumer receives the initial disclosure required by RESPA or Regulation Z, regardless of whether a revised version of the disclosure is subsequently provided to the consumer.

The creditor may pay the counseling fee for the consumer, but cannot condition payment of the fee on the consumer actually obtaining the high-cost mortgage loan. Alternatively, the consumer may pay the counseling fee, or may finance the fee as part of the credit transaction.

Homeownership Counseling Requirements for Negative Amortization Loans

Prior to extending a closed-end, dwelling-secured loan that permits negative amortization to a first-time borrower, the creditor must obtain sufficient documentation evidencing that the consumer has received homeownership counseling. The requirement applies specifically to first-time borrowers, and does not apply to borrowers who have received a mortgage loan in the past. The requirement does not apply to high-cost mortgage loans, as such loans cannot contain a negative amortization feature. Similar to the high-cost mortgage counseling requirement, the counselor providing homeownership counseling on a negative amortization loan must be approved by HUD.

List of Homeownership Counselors

The final rule creates a requirement under Regulation X, which implements RESPA, that the creditor provide an applicant for a federally-related mortgage loan with a written list of homeownership counseling organizations within three business days of receiving the application. This provision applies regardless of whether the transaction is a high-cost mortgage loan. The requirement does not apply to reverse mortgage loans or loans secured by a consumer's interest in a timeshare.

The creditor may generate a list of homeownership counseling organizations using the CFPB's website, www.consumerfinance.gov/find-a-housing-counselor. Alternatively, creditors may use the data provided by CFPB and HUD to create a list of homeownership counseling organizations. In an interpretive final rule issued on **November 8, 2013**, CFPB provided that as developing a method to generate lists of counseling organizations may take time, creditors who choose this option to generate a list may be unable to provide a list in this manner by the **January 10, 2014**, effective date of the requirement. In that case, creditors should consider the guidance provided in the interpretive final rule and consider generating lists using the CFPB website.

Regardless of how the list of counseling organizations is generated, only HUD-approved counseling agencies may appear on the list. In addition, the list must include the ten counseling agencies closest to the zip code of the borrower's current address, and must include ten specific data fields for each agency: (1) agency name; (2) phone number; (3) street address; (4) city; (5) state; (6) website URL; (7) email address; (8) zip code; (9) counseling services provided; and (10) languages spoken. The list must include the following text:

"The counseling agencies on this list are approved by the U.S. Department of Housing and Urban Development (HUD), and they can offer independent advice about whether a particular set of mortgage loan terms is a good fit based on your objectives and circumstances, often at little or no cost to you. This list shows you several approved agencies in your area. You can find other approved counseling agencies at the Consumer Financial Protection Bureau's (CFPB) website: consumerfinance.gov/mortgagehelp or by calling 1-855-411-CFPB (2372). You can also access a list of nationwide HUD-approved counseling intermediaries at http://portal.hud.gov/hudportal/HUD?src=/ohc_nint."

The rule does not require the consumer to obtain homeownership counseling prior to consummation of a federally-related mortgage loan; it merely requires the creditor to provide the consumer with a list of counseling organizations. The consumer may then decide whether to obtain counseling prior to consummating the loan.

Conclusion

The final rule issued by CFPB to amend HOEPA expands the scope of HOEPA to cover home purchase loans and HELOCs in addition to refinance transactions and closed-end home equity loans. The final rule also revised the rate and fee thresholds to determine whether a transaction is a high-cost mortgage, created a coverage test based on prepayment penalties, and prohibited various loan features on high-cost mortgages. As mentioned above, the rule applies to transactions for which the creditor or lender receives an application on or after **January 10, 2014**.

The rules issued by CFPB to amend the high-cost mortgage requirements may be found at the following links: http://www.gpo.gov/fdsys/pkg/FR-2013-01-31/pdf/2013-00740.pdf, http://files.consumerfinance.gov/f/201309_cfpb_titlexiv_updates.pdf, http://www.gpo.gov/fdsys/pkg/FR-2013-10-23/pdf/2013-24521.pdf, and http://files.consumerfinance.gov/f/201311_cfpb_interpretive-rule_homeownership-counseling-organizations-lists.pdf. In addition, CFPB has issued a small entity compliance guide on the high-cost mortgage requirements, which may be found at: http://files.consumerfinance.gov/f/201310_cfpb_home-ownership-and-equity-protection-act-rule-compliance-guide-updated-stickerupdate.pdf.

Update on Servicing Requirements under Regulations X and Z

Notice 2013-12

In January 2013, the Consumer Financial Protection Bureau (CFPB) issued final rules to amend Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA) and Regulation Z, which implements the Truth in Lending Act (TILA), to impose new requirements on servicers of mortgage loans as required by the Dodd-Frank Act. Subsequent final rules were issued in July and September 2013 to amend the servicing requirements. In October 2013, CFPB issued an interim final rule to clarify and further amend the servicing requirements, in addition to the homeownership counseling requirements for high-cost mortgages, which are discussed in Notice 2013-11 above. This article provides a brief overview of the amendments and clarifications of the servicing requirements that were made by the interim final rule issued in October 2013.

Exemptions When Borrowers File Bankruptcy

The Bankruptcy Code affords several protections to debtors who file bankruptcy, and the servicing requirements imposed by Regulations X and Z may conflict with those protections. For this reason, the interim final rule creates an exemption from the Regulation X requirement for servicers of mortgage loans to engage in early intervention with delinquent borrowers when a borrower has filed bankruptcy, as well as an exemption from the Regulation Z requirement to provide a periodic statement when a borrower has filed bankruptcy. The exemptions begin once a petition has been filed commencing a bankruptcy case under Title 11 of the United States Code in which the borrower is a debtor. When two or more borrowers are liable on a mortgage loan, the exemption applies if any of the borrowers have filed bankruptcy.

With respect to any portion of the mortgage debt that is not discharged in the bankruptcy case, the servicer must resume compliance with the Regulation X early intervention requirements for the first delinquency that occurs after the earliest of three potential outcomes of the bankruptcy case: (1) the case is dismissed; (2) the case is closed; or (3) the borrower receives a discharge under section 727, 1141, 1228, or 1328 of the Bankruptcy Code. The servicer must also resume sending periodic statements within a reasonably prompt time after the first payment due date that occurs after the earliest of those three potential outcomes.

Exemptions When Borrowers Exercise "Cease Communication" Rights

The Fair Debt Collection Practices Act (FDCPA) contains a "cease communication" provision which allows a borrower to send a written notice to instruct a debt collector to stop communicating with the borrower regarding the debt. To avoid conflicts with FDCPA, the interim final rule creates exemptions from two of the requirements imposed by Regulations X and Z when a borrower has invoked the cease communication provision. First, a servicer is not required to comply with the Regulation X requirement to engage in early intervention with delinquent borrowers. Second, the Regulation Z requirement to provide a notice to a consumer with an adjustable-rate mortgage loan (ARM loan) each time an interest rate adjustment causes a corresponding change in a payment amount does not apply. The exemptions apply to servicers that meet the definition of "debt collector" under FDCPA.

Conclusion

The interim final rule issued by CFPB in October 2013 creates exemptions from the early intervention, periodic statement, and ARM loan interest rate adjustment notice requirements imposed by Regulations X and Z to avoid conflicts with the Bankruptcy Code and FDCPA. The interim final rule may be found at: www.gpo.gov/fdsys/pkg/FR-2013-10-23/pdf/2013-24521.pdf. For more information on the servicing requirements under Regulations X and Z, please see the September and October 2013 editions of *WBA Compliance Journal.* ■

Conclusion

The final rule issued by CFPB to amend HOEPA expands the scope of HOEPA to cover home purchase loans and HELOCs in addition to refinance transactions and closed-end home equity loans. The final rule also revised the rate and fee thresholds to determine whether a transaction is a high-cost mortgage, created a coverage test based on prepayment penalties, and prohibited various loan features on high-cost mortgages. As mentioned above, the rule applies to transactions for which the creditor or lender receives an application on or after **January 10, 2014**.

The rules issued by CFPB to amend the high-cost mortgage requirements may be found at the following links: http://www.gpo.gov/fdsys/pkg/FR-2013-01-31/pdf/2013-00740.pdf, http://files.consumerfinance.gov/f/201309_cfpb_titlexiv_updates.pdf, http://www.gpo.gov/fdsys/pkg/FR-2013-10-23/pdf/2013-24521.pdf, and http://files.consumerfinance.gov/f/201311_cfpb_interpretive-rule_homeownership-counseling-organizations-lists.pdf. In addition, CFPB has issued a small entity compliance guide on the high-cost mortgage requirements, which may be found at: http://files.consumerfinance.gov/f/201310_cfpb_home-ownership-and-equity-protection-act-rule-compliance-guide-updated-stickerupdate.pdf.

Update on Servicing Requirements under Regulations X and Z

Notice 2013-12

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Exemptions When Borrowers File Bankruptcy

The Bankruptcy Code affords several protections to debtors who file bankruptcy, and the servicing requirements imposed by Regulations X and Z may conflict with those protections. For this reason, the interim final rule creates an exemption from the Regulation X requirement for servicers of mortgage loans to engage in early intervention with delinquent borrowers when a borrower has filed bankruptcy, as well as an exemption from the Regulation Z requirement to provide a periodic statement when a borrower has filed bankruptcy. The exemptions begin once a petition has been filed commencing a bankruptcy case under Title 11 of the United States Code in which the borrower is a debtor. When two or more borrowers are liable on a mortgage loan, the exemption applies if any of the borrowers have filed bankruptcy.

With respect to any portion of the mortgage debt that is not discharged in the bankruptcy case, the servicer must resume compliance with the Regulation X early intervention requirements for the first delinquency that occurs after the earliest of three potential outcomes of the bankruptcy case: (1) the case is dismissed; (2) the case is closed; or (3) the borrower receives a discharge under section 727, 1141, 1228, or 1328 of the Bankruptcy Code. The servicer must also resume sending periodic statements within a reasonably prompt time after the first payment due date that occurs after the earliest of those three potential outcomes.

Exemptions When Borrowers Exercise "Cease Communication" Rights

The Fair Debt Collection Practices Act (FDCPA) contains a "cease communication" provision which allows a borrower to send a written notice to instruct a debt collector to stop communicating with the borrower regarding the debt. To avoid conflicts with FDCPA, the interim final rule creates exemptions from two of the requirements imposed by Regulations X and Z when a borrower has invoked the cease communication provision. First, a servicer is not required to comply with the Regulation X requirement to engage in early intervention with delinquent borrowers. Second, the Regulation Z requirement to provide a notice to a consumer with an adjustable-rate mortgage loan (ARM loan) each time an interest rate adjustment causes a corresponding change in a payment amount does not apply. The exemptions apply to servicers that meet the definition of "debt collector" under FDCPA.

Conclusion

The interim final rule issued by CFPB in October 2013 creates exemptions from the early intervention, periodic statement, and ARM loan interest rate adjustment notice requirements imposed by Regulations X and Z to avoid conflicts with the Bankruptcy Code and FDCPA. The interim final rule may be found at: www.gpo.gov/fdsys/pkg/FR-2013-10-23/pdf/2013-24521.pdf. For more information on the servicing requirements under Regulations X and Z, please see the September and October 2013 editions of *WBA Compliance Journal.* ■

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Read "Special Focus" for an article regarding appraisal requirements under Regulation B, which implements ECOA, and Regulation Z, which implements TILA. Next, turn to "Regulatory Spotlight" for final CRA Q&As, FDIC & OCC supervisory guidance on deposit advance products, and FFIEC's guidance on social media compliance. Then, check "Compliance Notes" for DFI's 2014 escrow rate for mandatory escrow accounts under Wis. Stat. Sec. 138.052. ■

SPECIAL FOCUS

Appraisal Requirements under Regulations B and Z

Notice 2013-13

In January 2013, the Consumer Financial Protection Bureau (CFPB) issued final rules to amend Regulation B, which implements the Equal Credit Opportunity Act (ECOA) and Regulation Z, which implements the Truth in Lending Act (TILA), to impose new requirements with respect to appraisals and other written valuations of dwellings. CFPB also issued a subsequent final rule in December 2013 to exempt certain types of loans from the requirements. This article provides a brief overview of the new requirements, which apply to applications received on or after **January 18, 2014**.

ECOA Appraisal Requirements

The ECOA final rule requires creditors to notify applicants for loans to be secured by first liens on dwellings of their right to receive copies of all appraisals and other written valuations developed in connection with the application. The notice must be provided within three business days of receiving the application. The creditor must then deliver copies of all appraisals and written valuations of the dwelling to the applicant promptly upon completion, or three business days prior to consummation of the transaction (for closed-end) or account opening (for open-end), whichever is earlier.

Scope

The ECOA requirements apply to all applications for closed-end or open-end credit to be secured by a first lien on a dwelling, regardless of the purpose of the transaction. As a result, creditors must be mindful the ECOA requirements apply to consumer-, business- and agricultural-purpose loans. The requirements also apply to loss mitigation transactions such as loan modifications, short sales, or deed-in-lieu of foreclosure transactions, if they are "credit transactions" as defined in Regulation B. Additionally, the requirements apply when an applicant requests the renewal of an existing obligation of credit and the creditor develops a new appraisal or another written valuation. The requirements do not apply to the extent a creditor uses the appraisals and other written valuations that were previously developed in connection with the prior extension of credit to evaluate the renewal request.

The ECOA requirements do not apply to applications for credit to be secured by a subordinate lien on a dwelling, or for credit that will not be secured by a dwelling. Regulation B defines "dwelling" as a residential structure that contains one to four units, whether or not attached to real property. The definition includes, but is not limited to, individual condominium or cooperative units, mobile homes, and manufactured homes.

Upon receiving an application for closed-end credit to be secured by a dwelling, the creditor must determine whether the application is also subject to the TILA appraisal rule, as described in further detail below, as the two rules impose slightly different requirements.

Notice of Right to Receive Copies

Within three business days of receiving an application for credit to be secured by a first lien on a dwelling, the creditor must notify the applicant of his or her right to receive a copy of all appraisals or written valuations of the dwelling developed in connection with the application. If there is more than one applicant, the creditor may provide the notice to one of the applicants. If a primary applicant is readily apparent, however, the creditor must provide the notice to the primary applicant.

Appendix C to Regulation B provides sample language for the notice that must be provided to the applicant:

> "We may order an appraisal to determine the property's value and charge you for this appraisal. We will promptly give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost."

The final rule regarding integrated disclosures under TILA and the Real Estate Settlement Procedures Act (RESPA) includes this notice within the Loan Estimate, which the creditor must provide to the applicant within three business days of receiving an application subject to TILA and RESPA. If the Loan Estimate is provided to the applicant, the creditor need not provide a separate notice to satisfy the ECOA notice requirement.

If a creditor receives an application for credit that does not initially appear to be secured by a first lien on a dwelling, but the creditor later determines that the credit will be secured by a first lien on a dwelling, the creditor has three business days after the determination is made to notify the applicant of the right to receive copies of appraisals.

Appraisals and Written Valuations to be Provided to the Applicant

The ECOA final rule provides examples of documents that must be provided to the applicant: an appraiser's report that includes the appraiser's estimate of the property's value or opinion of value, a document prepared by the creditor's staff that assigns value to the property; a report approved by a government-sponsored entity (GSE) for describing to the applicant an estimate of the property's value developed by the GSE's proprietary methodology or mechanism; an automated valuation model report; or a broker price opinion prepared by a real estate broker, agent, or salesperson. The creditor must also provide any attachments or exhibits that are an integrated part of the valuation. If a valuation is developed in connection with the application, the creditor must provide the applicant a copy, even if the valuation is not used or is used only for a limited purpose. When a creditor receives more than one version of the same valuation, the latest version must be provided to the applicant. If, however, a creditor already has provided a copy of one version of an appraisal or other written valuation to an applicant, and the creditor later receives a revision of that appraisal or other written valuation, then the creditor also must provide the applicant with a copy of the revision to comply with the rule.

The rule also provides examples of documents that are *not* considered valuations, including internal documents that merely restate the estimated value of a dwelling contained in an appraisal or other written valuation that is provided to the applicant; government agency statements of appraised value that are publicly available; publicly available lists of valuations such as tax assessments; manufacturers' invoices for manufactured homes; reports reflecting property inspections that do not provide an estimate of the value of the property and are not used to develop an estimate of the value of the property; or appraisal reviews that do not include the appraiser's estimate of the property value or opinion of value.

Timing and Delivery of Copies to the Applicant

The ECOA final rule requires the creditor to provide the applicant with any estimate of value of a dwelling developed in connection with the application for credit promptly upon completion or at least three business days before consummation or account opening, whichever is earlier. According to the *Small Entity Compliance Guide* issued by CFPB, as Regulation B does not define "business day", if the loan is also subject to the TILA final rule described below, the creditor should consult Regulation Z to determine the required timing. CFPB further suggests that for other loans, the creditor may apply its own reasonable definition of "business day", which may include Saturdays.

When multiple valuations are obtained in connection with an application, a creditor might wait a few days after the completion of one valuation for another valuation to be completed, so that the copies of the valuations may be provided to the applicant at the same time. CFPB has outlined that waiting longer than a few days may reduce the likelihood that delivery of the first completed valuation will be considered "prompt". Whether delivery is considered "prompt" may vary depending on the facts and circumstances of the specific transaction, including when the creditor receives the appraisal and the extent of any review or revisions completed by the creditor after receipt.

The Official Commentary to Regulation B provides three examples in which the "promptly upon completion" standard would be satisfied. These examples assume the

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applicant receives the valuation copy no later than three business days before consummation or account opening: (1) fifteen days after application, the creditor's underwriting department reviews and approves an appraisal, and a copy is provided to the applicant one week later; (2) the creditor receives a revised appraisal 45 days after application and immediately determines it is acceptable, and provides a copy of the revised appraisal to the applicant one week later; and (3) the creditor receives an automated valuation model (AVM) report 5 days after receiving the application and treats the report as complete, and sends a copy to the applicant one week later.

The commentary also provides two examples in which the "promptly upon completion" standard would *not* be satisfied: (1) twelve days after application, the creditor approves an appraisal, and provides a copy to the applicant 42 days after application when the creditor schedules the consummation (or account opening) to occur on day 50; and (2) the creditor receives an AVM report five days after application, the creditor has also ordered an appraisal, but the initial version of the received appraisal is deemed deficient and sent to review. Creditor waits 30 days to provide a copy of the completed AVM report, until the appraisal is completed on day 35. Creditor then provides the applicant with copies of the AVM report and the revised appraisal. The commentary states that in this example the appraisal was provided promptly upon completion, but the AVM report was not.

The ECOA final rule allows the creditor to obtain a waiver of the prompt delivery requirement from the applicant. When a waiver is obtained, the creditor may wait until the loan closing or account opening to provide copies of all valuations to the applicant. The applicant's waiver may be provided orally or in writing, and generally must be provided at least three business days prior to consummation or account opening. If there is more than one applicant, any applicant may provide a waiver, but if a primary applicant is readily apparent, the primary applicant must provide the waiver.

If a creditor determines that the transaction will not be consummated or the account will not be opened, copies of valuations still must be provided promptly upon completion, unless the applicant has provided a waiver. If the applicant has provided a waiver, copies must be provided no later than 30 days after the creditor determines the transaction will not be consummated or the account will not be opened.

Copies may be sent to the applicant's physical or electronic address. Before providing the copies by electronic means, the creditor must obtain the applicant's consent to electronic delivery in accordance with the Electronic Signatures in Global and National Commerce Act (E-SIGN Act).

Charges to the Applicant

Creditors may charge applicants for the costs of the appraisals or valuations. Creditors are prohibited, however, from charging applicants for the cost of copying appraisals and valuations or for the cost of delivering the copies. The copying and delivery costs may not be recouped by the creditor by artificially increasing the cost of the appraisal or valuation.

The creditor must provide copies of any appraisals or written valuations developed in connection with the application, even if applicant has not paid the charge for the appraisal or valuation; the creditor may not condition providing a copy on payment of the charge.

TILA Appraisal Requirements for HPMLs

The TILA final rule requires creditors to notify applicants for higher-priced closed-end credit to be secured by a principal dwelling of the right to receive copies of appraisals, and to provide copies of all appraisals developed in connection with the application at least three business days before consummation of the loan. Such appraisals must include a physical inspection of the property's interior. An additional appraisal must be obtained if the property was acquired by the seller within the past 180 days and the purchase price exceeds certain thresholds.

Scope

The TILA appraisal requirements apply to higher-priced, closed-end consumer credit transactions secured by a consumer's principal dwelling. The requirements are not limited to applications for loans to be secured first liens; subordinate lien transactions are also covered. Regulation Z defines a higher-priced mortgage loan (HPML) as a closed-end consumer credit transaction secured by the consumer's principal dwelling with an annual percentage rate (APR) that exceeds the average prime offer rate (APOR) for a comparable transaction as of the date the interest rate is set by: (1) 1.5 or more percentage points for a loan secured by a first lien; (2) 2.5 or more percentage points for a loan secured by a first lien with a principal obligation at consummation that exceeds the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac (a "jumbo loan"); or (3) 3.5 or more percentage points for a loan secured by a subordinate lien.

The January 2013 TILA final rule exempts several types of transactions from the requirements: qualified mortgages, as defined in section 1026.43(e) of Regulation Z; "bridge" loans for a term of twelve months or less that are used by consumers to acquire new principal dwellings; loans to finance the initial construction of a dwelling; loans secured by new manufactured homes; loans secured by boats, trailers and motor homes; and reverse mortgage loans.

The December 2013 TILA final rule exempts transactions of $25,000 or less (indexed for inflation) and certain streamlined refinance transactions, where the holder of the credit risk of the existing obligation remains the same on the refinancing. To qualify for the streamlined refinance exemption, the periodic payments under the refinance transaction must not result in negative amortization, cover only interest on the loan, or result in a balloon payment. In addition, the proceeds from the refinance transaction may only be used to pay off the existing obligation and to pay closing or settlement charges.

The December 2013 TILA final rule also creates a temporary exemption of 18 months, until **July 18, 2015**, for loans secured in whole or part by a manufactured home. With respect to HPML applications received on or after **July 18, 2015**: (1) transactions secured by a new manufactured home and land will be exempt from the requirement that the appraisal include a physical inspection of the interior of the property, but will be subject to all other HPML appraisal requirements; (2) transactions secured by an existing (used) manufactured home and land will be subject to all of the TILA appraisal requirements; and (3) transactions secured solely by a manufactured home and not land will be exempt from the appraisal requirements if the creditor provides the consumer with a manufacturer's invoice of the unit cost, an independent cost service unit cost, or a valuation conducted by an individual who has no financial interest in the property or credit transaction, and has training in valuing manufactured homes.

Notice of Right to Receive Copies

Within three business days of receiving an application subject to the TILA final rule, the creditor must disclose to the applicant that they are entitled to a free copy of any appraisal developed in connection with the application, and that the applicant may hire an appraiser at their own expense for their own use. For applications subject to both the ECOA and TILA requirements, the creditor may use the notice required by the ECOA final rule, as described above, to satisfy the TILA notice requirement. In addition, as with the ECOA notice requirement, when the creditor provides the applicant a Loan Estimate under the TILA/RESPA integrated disclosure final rule, the appraisal notice included within the Loan Estimate satisfies the TILA notice requirement.

Appraisal Requirements

The TILA final rule requires the creditor to obtain a written appraisal performed by a licensed or certified appraiser who conducts a physical visit of the interior of the property that will secure the transaction. The TILA rule provides a safe harbor that would establish affirmative steps creditors can follow to ensure satisfaction of TILA statutory obligation. Specifically, a creditor would be deemed to have obtained a written appraisal that meets the general appraisal requirements adopted in 1026.35 (c)(3)(i) if the creditor: (1) orders the appraiser to perform the appraisal in conformity with the Uniform Standards of Professional Appraisal Practice (USPAP) and the Financial Institutions Reform Recovery & Enforcement Act (FIRREA) title XI, and any implements regulations, in effect at the time the appraiser signs the appraisers certification; (2) verifies through the National Registry that the appraiser who signed the appraiser's certification holds valid appraisal license or certification in the state in which the appraised property is located as of the date the appraisal is signed; (3) confirms the elements set forth in appendix N of Regulation Z are addressed in the written appraisal; and (4) has no actual knowledge to the contrary of facts or certifications contained in the written appraisal. While the Official Commentary to Regulation Z provides that creditors who satisfy these safe harbor conditions comply with the TILA appraisal requirements, it also provides that a creditor that does not satisfy the safe harbor conditions does not necessarily violate the appraisal requirements of TILA.

As mentioned, appendix N to Regulation Z provides steps the creditor may check to confirm that the appraisal qualifies for the safe harbor. These include: (a) identifies the creditor who ordered the appraisal, the property, and the interest being appraised; (b) indicates whether the contract price was analyzed; (c) addresses conditions in the property's neighborhood; (d) addresses the condition of the property and any improvements to the property; (e) indicates which valuation approaches were used and includes a reconciliation if more than one valuation approach was used; (f) provides an opinion of the property's market value and an effective date for the opinion; (g) indicates that a physical property visit of the interior of the property was performed; and (h) includes a certification signed by the appraiser that the appraisal was prepared in accordance with the requirements of USPAP and title XI of FIRREA, and any implementing regulations.

Delivery of Copies

The creditor must provide copies of all appraisals developed in connection with the application to the applicant at least three business days before consummation. Creditors are prohibited from charging the consumer for a copy of a required appraisal, including by marking up the interest rates or any other free payable by the consumer in connection with loan. In contrast to the ECOA final rule, the TILA final rule does not allow the applicant to waive the timing requirement that copies be provided at least three business days before consummation. Under Regulation Z, "business day" is defined as a day when the creditor's offices are open to the public for carrying on substantially all of its business functions. Delivery occurs three business days after the creditor mails or transmits the copies, or when the creditor has evidence indicating that the applicant received the copies.

Copies may be sent to the applicant's last-known physical or electronic address. In order to provide the copies by electronic delivery, the creditor must obtain consent from the applicant in accordance with the E-SIGN Act. If there is more than one applicant, the creditor may satisfy the TILA requirement by providing the copies to any applicant.

If the creditor determines the loan will not be consummated, the creditor is still required to provide copies of all appraisals to the applicant within 30 days of determining the loan will not be consummated. If the application is also covered by the ECOA final rule, the creditor must follow the ECOA requirement to provide the copies promptly upon completion, unless the applicant has provided a waiver of this requirement. Under both ECOA and TILA, the creditor may not charge the applicant a fee for the copies or for the cost of delivering the copies.

Property Flips

If the seller of the property acquired the dwelling within the preceding 180 days and the sale price exceeds certain thresholds, the creditor must obtain an additional appraisal. The additional appraisal must be obtained at the creditor's expense. The appraisal created when the seller acquired the property cannot be used to satisfy this requirement. Several types of transactions are exempt from the additional appraisal requirement.

Scope of Requirement

If the property was acquired by the seller in the preceding 90 days, and the purchase price reflects more than a 10% increase over the seller's acquisition price, an additional appraisal is required. If the property was acquired by the seller in the past 91-180 days, and the purchase price reflects more than a 20% increase over the seller's acquisition price, an additional appraisal is required.

The seller's acquisition date is the day the seller became the legal owner of the property. The purchase date is the day the consumer and the seller signed a home purchase agreement concerning the property. If the parties signed the agreement on different days, the creditor should use the later of the two dates. To determine whether the seller acquired the property in the past 180 days, the creditor should begin counting the day after the seller's acquisition date and count up to and including the buyer's purchase date. For example, if the seller acquired the property on April 17, 2012, and the buyer agreed to purchase the property on October 15, 2012, the creditor would count the dates from April 18, 2012 through October 15, 2012. In this example, 181 days passed from the seller's acquisition date to the date of the buyer's commitment to purchase the property, so the additional appraisal is not required.

As is outlined in appendix O of Regulation Z, the creditor may use written documents to show reasonable diligence in determining whether the seller acquired the property in the preceding 180 days, such as a copy of : (1) recorded deed from the seller; (2) property tax bill; (3) an owner's title insurance policy purchased by the seller; (4) a RESPA settlement statement from the seller's loan closing; (5) a property sales history report or title report from a third-party reporting service; (6) sales price data recorded in multiple listing services; (7) tax assessment records obtained from the local government; (8) a written appraisal performed in compliance with USPAP and FIRREA requirements for the seller's acquisition transaction; (9) title commitment report detailing the seller's ownership of the property, the date the property was acquired, or the price at which the seller acquired the property; or (10) a property abstract. If the creditor exercises reasonable diligence and cannot determine whether the property was acquired by the seller within the preceding 180 days, and cannot determine whether the difference between the seller's acquisition price and the buyer's purchase price exceeds the applicable threshold described above, the creditor must obtain the additional appraisal.

Additional Appraisal Requirements

The additional appraisal must meet the same requirements as the first appraisal obtained in connection with the application; it must be a written report by a certified or licensed appraiser completed in compliance with USPAP and FIRREA and based on an interior property visit. The additional appraisal must also analyze the difference in the seller's acquisition price and the buyer's purchase price, changes in market conditions, and property improvements made by the seller.

The two appraisers providing appraisal reports in connection with the application must be independent of each other. If the appraisers are affiliated, such as appraisers who work for the same appraisal firm, whether they have conducted the appraisals independently of each other must be determined based on the facts and circumstances of the particular case known to the creditor.

Exemptions from Additional Appraisal Requirement

The additional appraisal requirement does not apply to several types of transactions. If the HPML is used to acquire the property from any of the following, the requirement does not apply: (1) a local, state or federal government agency; (2) a person who acquired title from the holder of a defaulted mortgage on the property via foreclosure, deed-in-lieu of foreclosure, or another similar judicial or non-judicial procedure through exercise of the holder's rights in a defaulted loan; (3) a nonprofit entity as part of a local, state or federal government program that allows nonprofits to acquire title to single-family properties for resale from a seller who acquired title to the property through foreclosure, deed-in-lieu of foreclosure or another similar judicial or non-judicial procedure; (4) a person who inherited the property or acquired it through a court-ordered dissolution of marriage, civil union or domestic partnership, or through the partition of the seller's joint or marital assets;

(5) an employer or relocation agency in connection with an employee relocation; or (6) a service member who received a deployment or permanent change of station order after purchasing the property.

In addition, the requirement does not apply if an HPML is used to acquire a property: (1) located in a presidentially-declared disaster area during any time period when the federal financial institutions regulatory agencies waive the requirements in title XI of FIRREA and any implementing regulations in that area; or (2) located in a rural county, meaning a county located in the U.S. Department of Agriculture's Economic Research Service Urban Influence Codes 4, 6, 7, 8, 9, 10, 11 or 12. CFPB has published a final list of rural counties for use in 2014, which may be found at: www.consumerfinance.gov/blog/final-list-of-rural-and-underserved-counties-for-use-in-2014/.

Transactions Subject to Both Requirements

Creditors must determine whether an application is subject to the ECOA final rule, the TILA final rule, or both, as the scope of the two rules and their requirements differ.

The ECOA final rule applies only to loans secured by first liens on dwellings, while the TILA final rule applies to loans secured by first or subordinate liens. The ECOA final rule applies to transactions secured by any dwelling for any purpose, while the TILA final rule applies only when the transaction is for a consumer purpose and is secured by a principal dwelling. The ECOA final rule does not exempt any transaction that is secured by a first lien on a dwelling, while the TILA final rule exempts several types of transactions.

If an application for credit is covered by both rules, the disclosure required by the ECOA final rule can be used to satisfy the requirements of the TILA final rule. The timing requirements of the two rules also differ. When both rules apply, the creditor should follow the rule that provides the earlier deadline for delivering appraisal copies, keeping in mind that waiver of the deadline is not an option under the TILA final rule. When both rules apply and there are multiple applicants, the creditor must follow the ECOA final rule and deliver the notice and copies to the primary applicant when one is apparent.

State Law Requirement

Creditors are also reminded of a separate Wisconsin state law requirement as found under Wisconsin Statute section 224.25. Specifically, that section provides that if requested by an individual who is a customer, loan applicant or credit applicant, a creditor must provide that individual with a copy of any written appraisal report which is held by the creditor, which relates to residential real estate that the individual owns or has agreed to purchase and for which a fee is imposed. This state law requirement may apply when the ECOA or TILA requirements otherwise would not.

Conclusion

CFPB has issued two final rules to amend the appraisal requirements under Regulation B and Regulation Z. For certain applications received on or after **January 18, 2014**, creditors must provide applicants with a notice of their right to receive copies of all appraisals or written valuations developed in connection with the application. Creditors generally must provide such copies either promptly upon completion or at least three business days before consummation of the loan or account opening, whichever is earlier. The ECOA final rule may be found at: www.gpo.gov/fdsys/pkg/FR-2013-01-31/pdf/2013-01384.pdf. The TILA final rules may be found at: www.gpo.gov/fdsys/pkg/FR-2013-02-13/pdf/2013-01809.pdf and http://files.consumerfinance.gov/f/201312_cfpb_appraisals-for-higher-priced-mortgage-loans_supplemental-final-rule.pdf. In addition, CFPB has issued a small entity compliance guide to each rule, which may be found at: www.consumerfinance.gov/regulatory-implementation/. ■

REGULATORY SPOTLIGHT

Agencies Issue Final Rule to Amend BSA Definitions.

The Board of Governors of the Federal Reserve System (FRB) and Financial Crimes Enforcement Network (FinCEN) (collectively, the Agencies) have issued a final rule to amend the regulatory definitions of "funds transfer" and "transmittal of funds" under the regulations implementing the Bank Secrecy Act (BSA). The final rule amends the definitions to maintain their current scope in light of changes to the Electronic Fund Transfer Act, which will avoid certain currently covered transactions being excluded from BSA requirements. The final rule is effective **01/03/2014**. Copies of the final rule may be obtained from WBA or viewed at: http://www.gpo.gov/fdsys/pkg/FR-2013-12-04/pdf/2013-28951.pdf. *Federal Register*, Vol. 78, No. 233, 12/04/2013, 72813-72817.

Agencies Issue Final "Volcker Rule" and FAQs.

- The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC),