WISCONSIN BANKERS ASSOCIATION
Compliance Journal

Volume 20, Number 8 January 2016

Read "Special Focus" for an article on a recent court case where the Wisconsin Court of Appeals upheld the jury's decision to award damages to a buyer of foreclosed real estate based on a deceptive representation despite that the sale was "as is", and steps banks should take when selling OREO in light of this case. Next, turn to "Regulatory Spotlight" for a final rule on CRA. Finally, see "Compliance Notes" for a reminder that the transition period for small creditors to make balloon qualified mortgages, regardless of where the small creditor operates, sunsets **04/01/2016**. ■

SPECIAL FOCUS

Banks Should Take Additional Care When Selling OREO.

Notice 2016-1

OREO properties are usually sold "AS IS." But in *Fricano v. Bank of America (December, 2015)*, the Wisconsin Court of Appeals upheld a jury's award of damages to a buyer of foreclosed real estate based on a deceptive representation, despite the fact that the sale was AS IS. The decision is troubling because the seller, Bank of America, took reasonable steps to protect itself from the very claim asserted by the buyer, to no avail. Before analyzing the decision, some background on the relevant legalese is in order.

Representations & Warranties Come from Multiple Sources

The phrase AS-IS—which signals "Buyer Beware!"—is commonly seen in sale contracts; frequently set off in boldfaced, capital letters; and often accompanied by elaborate "disclaimers" of representations and warranties. "Representations and warranties" refer to statements of fact made by one party to a contract to induce another party to enter into the agreement. The opposite of disclaimers, they signal "Don't Worry" to a buyer. Although the two terms are almost always joined as a couplet in contracts, they do not have identical meanings. And while the technical difference between representations and warranties is beyond the scope of this article, the best practice for banks selling OREO is to make as few as possible.

Representations and warranties in the sale of real estate are common. They generally arise in one of three ways: (1) they are made expressly—that is, written into the contract or stated orally; (2) they are implied by law—judicially created because the facts and circumstances of a sale give rise to a duty to make them; or (3) they are required by statute.

Express representations are the most common. Before a bank can sell OREO, its employees and realtors will necessarily have to talk to potential buyers about the condition of the property. Listing the property for sale on the MLS requires the bank's realtor to detail salient facts. Any of these statements might amount to a representation or warranty.

Implied representations and warranties make matters trickier. The law imposes upon banks (and indeed all sellers) a duty to disclose matters that are known to the bank, that are material to the transaction, and that are not readily discernible to the buyer. When the facts or circumstances so dictate, the law also sometimes "implies" warranties of habitability, merchantability, and fitness for a particular purpose where none have been given expressly.

There are two common sources of statutory duties giving rise to claims for breach of representation or warranty. The first is Chapter 709 of the Wisconsin Statutes, which makes it customary for sellers to give buyers an elaborate set of representations, detailing known defects in property in a "Real Estate Condition Report." Lawsuits based on problems with RECRs are common. But an elaborate discussion of Chapter 709 is unnecessary, because banks can and should ask buyers to waive receipt of this report, thereby avoiding liability for RECRs.

The second source of statutory duty is Section 100.18 of the Statutes, which prohibits untrue, misleading, or deceptive advertising. Courts routinely apply this statute to representations in the sale of real estate, any time there are statements made to the general public (such as, for example, an MLS listing). A consumer who relies on false advertising is entitled to damages plus attorneys' fees. It was this statute that triggered liability in *Fricano*.

How to Limit Representations & Warranties

So what's a bank to do to limit its liability in light of the risk that its agent might make express representations, or a court might find an implied representation? The common answer is to sell the property AS-IS. A well-drafted AS-IS clause reduces liability in several ways:

- Limiting express representations to those written into the sale contract
- Negating express representations that a bank's employees or realtors might have made before the sale contract was signed
- Negating implied representations that might exist at law
- Negating any legal duty that the bank might have to make representations to a buyer (such as Chapter 709)
- Transferring to the buyer the onus to inspect the property, and to rely solely on its inspections in making its decision about whether to proceed to closing.

But even a well-drafted AS-IS clause is not a panacea. A bank remains liable for breach of any express representation in the contract. A court could also hold a bank liable for an implied misrepresentation: failing to disclose a particularly egregious problem that is known to the bank, material to the transaction, and not readily discernable to the buyer. Both of these factors played a role in the *Fricano* case.

AS IS Didn't Work in Fricano

The bank in *Fricano* acquired a residence in foreclosure that had suffered from severe flooding: the water bill showed almost 250,000 gallons of water had been spilled from burst pipes. Ceilings throughout the home had fallen in. The bank hired contractors to rebuild the residence to make it presentable, but the extent of the water incursion was so extensive that mold problems had already developed. There was evidence that the bank knew that the steps taken to remediate the mold were insufficient. But the bank proceeded to list the property for sale.

There was great interest from the public and multiple offers to purchase. Fricano was the successful bidder. She sent an offer to purchase to the bank. The bank accepted her offer, subject to an addendum to the contract prepared by the bank. The addendum contained a well-drafted AS-IS clause—an elaborate clause indeed, which ticked off all of the points outlined above and then some; a clause that practically screamed "Buyer Beware!" But the addendum also contained a statement that the bank had acquired the property by foreclosure and consequently had "*little or no direct knowledge about the condition of the Property*." Fricano signed the addendum.

The bank's *little or no direct knowledge* statement was demonstrably false; it knew that water damage to the property was severe, that mold was likely, and that its mold remediation efforts to date were probably insufficient. The jury awarded damages to the buyer for three reasons. First, an AS IS clause does not relieve a seller from a duty to disclose a material adverse fact. Second, the buyer relied on the bank's statement that it had no knowledge about the condition of the property. Third the bank's *little or no direct knowledge* statement was placed before one or more members of the public, thereby making it deceptive advertising under Section 100.18.

On appeal, the bank argued that the AS IS clause expressly disclaimed any representation or warranty with respect to mold claims. In other words, the bank disclaimed the very claim that Fricano was making! The court of appeals, however, held that the bank's little or no direct knowledge statement was untrue, and an AS IS clause does not protect the bank from false representations. In other words, had the bank not made that statement, the AS IS clause would have been effective.

However, the express representation in this case—*little or no direct knowledge*—does not seem like a representation at all. Recall that a representation is a statement made to *induce* a party to enter into a contract. Had the bank represented that it "had no knowledge of flooding or mold," a disclaimer would be clearly ineffective. But to say it had *little or no direct knowledge* of the condition of the property signals "Buyer Beware" rather than "Don't Worry." The statement is more like a disclaimer than a representation.

Moreover, every false statement is a misrepresentation, but not every misrepresentation results in liability. A buyer has to *reasonably rely* upon the misrepresented fact. Consider the statement "the roof of this house has never leaked while we have lived here." If there's no visible evidence to the contrary, reliance is reasonable. But if there is a gaping hole in the roof and water stains across the ceilings and walls, then the buyer's reliance on the statement that contradicts the clear facts becomes unreasonable.

In *Fricano*, there was clear evidence of mold in the home at the time the buyer inspected the property. The addendum that the bank required her to sign expressly disclosed the possibility of mold, and required her to waive claims against the bank in connection with "any known or unknown conditions of the Property, including … the existence of toxic mold." These facts make Fricano's reliance seem unreasonable. Nevertheless, despite the court's focus on the alleged false statement made by the bank, the trigger for

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liability in this case was probably the fact that the bank actively concealed the defects in the property caused by the flooding.

Best Practices Takeaway

Fricano reminds us that AS IS is not an absolute safe harbor for banks. When selling OREO, banks should handle the issues of representations and warranties with special care. The first step is to remind employees and agents to not make representations or warranties while marketing the property, taking care to avoid liability for false advertising claims. The second step is to carefully draft the contract to contain (1) **only** limited, express representations that are true, and (2) an AS IS clause that negates the bank's duties to disclose, that negates implied representations and warranties, and that puts the onus on the buyer to inspect the property. And the third step is to evaluate whether any defect of the property is so severe, and so difficult for the average buyer to discern, that a court might impose liability for failure to disclose it despite an AS IS clause. By carefully following each of these steps, banks can put themselves in the best position to avoid liability for misrepresentation.

WBA wishes to thank John P. Starkweather, attorney with Boardman & Clark LLP, for providing this article. ■

REGULATORY SPOTLIGHT

Agencies Issue Semiannual Regulatory Agendas.

- The Bureau of Consumer Financial Protection (CFPB) has published its Fall 2015 semiannual regulatory agenda in the *Federal Register*. CFPB reasonably anticipates having the regulatory matters identified within the agenda under consideration during the period from **11/01/2015** through **10/31/2016**. The next agenda will be published in spring 2016 and will update the agenda through spring 2017. The information within the agenda is current as of **09/18/2015**. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-15/pdf/2015-30668.pdf. *Federal Register*, Vol. 80, No. 240, 12/15/2015, 78056-78060.

- The Board of Governors of the Federal Reserve System (FRB) has issued its semiannual regulatory agenda. FRB anticipates considering the regulatory matters indicated within the agenda during the period **11/01/2015** through **04/30/2016**. The next agenda will be published in spring 2016. Comments may be submitted anytime during the next six months. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-15/pdf/2015-30675.pdf. *Federal Register*, Vol. 80, No. 240, 12/15/2015, 78104-78105.

- The Department of Housing and Urban Development (HUD) has issued its agenda of regulations already issued or that are expected to be issued during the next several months. The agenda also includes rules currently in effect that are under review and describes those regulations that may affect small entities. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-15/pdf/2015-30681.pdf. *Federal Register*, Vol. 80, No. 240, 12/15/2015, 77980-77981.

- The Department of the Treasury (Treasury) has issued its semiannual regulatory agenda. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-15/pdf/2015-31005.pdf. *Federal Register*, Vol. 80, No. 240, 12/15/2015, 78018.

- The Small Business Administration (SBA) has issued its semiannual regulatory agenda, which includes all current and projected rulemakings, existing regulations, and completed actions of SBA. Comments may be submitted on any aspect of the agenda. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-15/pdf/2015-30665.pdf. *Federal Register*, Vol. 80, No. 240, 12/15/2015, 78040-78046.

- The Securities and Exchange Commission (SEC) has issued its semiannual regulatory agenda. Information in the agenda was accurate on **09/25/2015**, the date on which SEC's staff completed compilation of the data. To the extent possible, rulemaking actions by SEC since that date have been reflected in the agenda. SEC invites questions and comment on the agenda and on the individual agenda entries. Comments were due **01/14/2016**. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-15/pdf/2015-30678.pdf. *Federal Register*, Vol. 80, No. 240, 12/15/2015, 78112-78115.

- The Federal Communications Commission (FCC) has issued its semiannual regulatory agenda. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2015-12-15/pdf/2015-30673.pdf. *Federal Register*, Vol. 80, No. 240, 12/15/2015, 78066-78102.

- The Department of Defense (DOD) has issued its semiannual regulatory agenda. Copies of the agenda

WISCONSIN BANKERS ASSOCIATION
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Read "Special Focus" for an article regarding a new Wisconsin law intended to eliminate verbal contract claims against banks and other financial intuitions. Next, turn to "Judicial Spotlight" for an article regarding a recent court opinion, which found that "suspicion" of improperly-pledged collateral reduces a creditor's position in bankruptcy. See "Regulatory Spotlight" for information about a Compliance Bulletin issued by CFPB regarding accurate FCRA reporting and for a correction CFPB made to the TILA/RESPA Integrated Disclosure rule. Finally, see "Compliance Notes" for information about CFPB's webinar that will address the TILA/RESPA Integrated Disclosures rule and construction lending. ■

SPECIAL FOCUS

New Wisconsin Law Helps Insulate Banks From Lender Liability

Notice 2016-2

After a long continuous effort by the Wisconsin Bankers Association, the Legislature passed and the Governor signed a new law in Wisconsin intended to eliminate verbal contract claims against banks and other financial institutions. The new law is 2015 Wisconsin Act 120 (the "Act"). The Act first applies to legal actions brought against banks and other financial institutions on or after December 18, 2015.

In the 1980's and 1990's, several lender liability lawsuits were brought against banks that resulted in huge dollar judgments against those banks. Those lawsuits were often based on alleged oral commitments to lend money, to refinance loans or to forbear from exercising certain remedies available under written agreements. Over 40 states have enacted similar laws to protect banks from lawsuits over discussions and understandings that are not expressed in written and signed documents. Until the enactment of these laws, the law in many states, including Wisconsin, did not require that commercial credit agreements be in writing to be enforceable against banks. All of our neighboring states, including Minnesota, Iowa, Illinois and Michigan have enacted such laws to protect banks, and Wisconsin has now joined this list of states by passing a law to require that credit agreements with banks be in writing and signed by the bank to be enforceable against the bank by the other party.

These laws were enacted in part to provide more certainty in credit transactions and to reduce or eliminate litigation over alleged oral contracts where banks and their customers often have different recollections regarding the discussions. Essentially, with a few exceptions, the Act insulates banks from lender liability lawsuits based on oral discussions.

There are a few important exceptions to the protections granted banks by the Act. In particular, the Act does not affect claims against banks alleging fraudulent representation or misrepresentation under Wisconsin law, including Wisconsin's Deceptive Trade Practices Act under Section 100.18, Wisconsin Statutes. The Act also does not apply to credit transactions of $25,000 or less with consumers that are subject to the Wisconsin Consumer Act or to the issuance or use of credit cards whether or not governed by the Wisconsin Consumer Act.

The following is a brief explanation of the Act:

The Act is broad in terms of financial institutions protected under the Act. The Act extends its protections to all banks, savings banks, savings and loan associations and credit unions organized under the laws of any state, including Wisconsin, or federal law. The Act also extends its protections to an "affiliate" of a bank or other protected financial institution. "Affiliate" means a business entity that controls, is controlled by, or is under common control with the bank or other protected financial institution. The Act also protects the Farm Credit Administration and its affiliates.

The Act is also broad in terms of the types of agreements and transactions protected under the Act. **Under the Act, no legal action may be brought against a bank, other protected financial institution or an affiliate on or in connection with any offer, promise, agreement or commitment to lend money, to grant or extend credit, to make any other financial accommodation, to renew, extend or modify any loan or other financial accommodation or to permit a delay in the payment or performance of any loan or other financial accommodation unless it is in writing, sets forth relevant terms and conditions, is signed with an authorized signature by the bank, other protected financial institution or an affiliate and is delivered to the other party attempting to enforce the offer, promise, agreement or commitment against the bank, other protected financial institution or an affiliate.**

The Act further protects financial institutions by providing that an offer, promise, agreement or commitment may not be enforced under the doctrine of promissory estoppel. If the Act had not prevented the use of the doctrine of promissory estoppel that failure would have provided a significant loophole through which enforcement of alleged oral agreements or promises could have been attempted notwithstanding the protections provided by the Act. Fortunately, this loophole was not included in the Act.

Notwithstanding the protection for banks and other financial institutions from the use of the doctrine of promissory estoppel, the Act does not prohibit actions or claims against banks or other financial institutions for fraudulent representations or misrepresentations under Wisconsin law, including Wisconsin's Deceptive Trade Practices Act under Section 100.18, Wisconsin Statutes. In general, Wisconsin's Deceptive Trade Practices Act protects the public from representations made with the intent to induce an obligation that were untrue, deceptive or misleading and caused the other party a financial loss. Although it is unlikely a bank or other financial institution would engage in such conduct, the failure of the Legislature to protect banks and other financial institutions from actions based on such allegations could be a concern in connection with an egregious fact situation involving a bank or other financial institution. For this reason, the Act cannot be seen as an absolute and total protection for banks and other financial institutions against all actions if those actions are based upon these certain allegations that are exceptions under the Act.

Finally, the Act first applies to an action commenced against a bank or other financial institution on or after December 18, 2015. Since the Act is specifically made applicable to "actions" commenced on or after December 18, 2015, one could reasonably argue that the Act is retroactive with respect to alleged oral agreements made prior to December 18, 2015.

What might all of this mean to standard bank practices? As has always been the case, written agreements meeting the requirements of the Act continue to be enforceable against banks. It is best for banks to be clear and cautious with respect to those written agreements. Further, if written documents are not intended to be enforceable agreements, it would be best to clearly indicate in the document that it is not intended to be a binding agreement between the parties. Banks would be well advised to consult with their counsel regarding the appropriate disclamatory language. Therefore, with respect to written agreements, there probably will be no change going forward for banks other than to continue to follow best practices when preparing and distributing written agreements. Regarding oral communications, banks will probably be less concerned that their oral discussions may lead to enforceable agreements since oral discussions under this Act cannot be enforced as binding agreements absent fraudulent representation or misrepresentation.

In summary, the adoption of this Act in Wisconsin should help put an end to concerns by banks and their counsel over the legal effect of oral discussions between banks and their customers absent fraudulent representation or misrepresentation. I have always cautioned banks in my discussions with them that in Wisconsin verbal contracts may be enforceable. I am pleased to say my advice is no longer appropriate thanks to this recent helpful change in Wisconsin law.

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

JUDICIAL SPOTLIGHT

Court Says "Suspicion" of Improperly-Pledged Collateral Reduces Creditor's Position in Bankruptcy.

On January 8, 2016, the Seventh Circuit Federal Court of Appeals issued an opinion in *In re Sentinel Management Group* finding that Bank of New York Mellon Corp. (BNYM) forfeited its position as a senior secured creditor in Sentinel Management Group's (Sentinel) bankruptcy because it was on "inquiry notice" that collateral for loans had been unlawfully pledged. This decision has important implications for Wisconsin banks in lending transactions.

Sentinel, a cash-management firm, was in the business of investing cash from consumers in liquid low-risk securities and also traded on its own account. To finance its own trades, Sentinel borrowed money from BNYM—up to $573

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Read "Special Focus" for an article regarding DFI's new interpretation on the installation and use of GPS units and starter-interrupt devices in connection with a lienholder's repossession of collateral. Next, turn to "Regulatory Spotlight" for an interim final rule regarding an expanded 18-month examination cycle for certain small insured depository institutions. Finally, see "Compliance Notes" for an OCC, FRB and FDIC joint advisory on the use of evaluations instead of appraisals when estimating the market value of real property that secures real estate-related financial transactions. ■

SPECIAL FOCUS

Wisconsin DFI Permits Use of GPS and Starter-Interrupt Devices.

Notice 2016-3

Until recently, under interpretations previously issued by the Wisconsin Department of Financial Institutions ("DFI"), it was a prohibited practice under the Wisconsin Consumer Act ("WCA") for a lienholder of a motor vehicle to utilize a device with a "starter-interrupt" feature that could be engaged to remotely disable a car's operation following default. Prior interpretations from DFI on this subject, including one issued in 2012, had stated explicitly that the use of such a device was prohibited, constituted an "unfair collection practice" and violated the WCA. Accordingly, Wisconsin car dealers and others in Wisconsin who financed the sale of motor vehicles to borrowers were unable to install and use these "payment assurance" devices, without risk of violating Wisconsin's consumer credit laws.

Wisconsin remained one of the only states in the country where, due to regulatory restrictions, secured motor vehicle lenders could not legally utilize the latest electronic technology aimed at assuring that borrowers make their car payments when due. Use of these devices in other states has resulted in interest rates remaining lower on used cars where these devices are installed, as well as lower numbers of car repossessions since borrowers tend to make payments when reminded instead of the alternative of having their vehicles' operations disabled.

In 2015, Wisconsin enacted a new law (Wis. Stats. § 940.315), which made it a crime to use a GPS tracking device on someone else's motor vehicle other than in certain "exempted" situations. One of these permitted situations for using a GPS device is for a lienholder to locate a vehicle in connection with the repossession of collateral.

However, some questions have arisen since passage of the new GPS law about the interplay of this law with the WCA, relating to repossessions of motor vehicles. In addition, questions remained for lenders about the use of "starter-interrupt" technology, which technology often is embedded today in GPS units that are installed in cars being financed.

A new interpretation that was recently added to DFI's website clarifies that agency's position on the installation and use of GPS units and starter-interrupt devices in connection with a lienholder's repossession of collateral. (The new interpretation can be found at https://www.wdfi.org/wca/business_guidance/interpretive_opinions/Installation_of_GPS_Device_on_a_Vehicle.htm.) The new language added to DFI's website in January 2016 is titled "Installation of GPS and/or Starter Interrupt Technology on a Vehicle." It states that:

> "Installation of a GPS and/or a device that is designed to remotely disable a vehicle is not illegal. However, use of this technology must comply with the Wisconsin Consumer Act in addition to any other laws that may govern the usage in a particular situation. This statement supersedes and replaces any previous statements or positions of the department on this issue."

Under the WCA, before a creditor may repossess a motor vehicle after default, a notice of right to cure must be sent, in addition to notifying the borrower of their right to participate in a court hearing. Thus, under DFI's interpretation requiring compliance with applicable provisions in the WCA, a secured creditor utilizing a GPS or starter-interrupt device must assure that all of the WCA's required statutory notices, restrictions and waiting periods have been complied with before utilizing this electronic technology.

WBA wishes to thank Atty. James A. Sheriff, Reinhart Boerner Van Deuren, s.c. for providing this article. ■

WISCONSIN BANKERS ASSOCIATION
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Read "Special Focus" for an article regarding CFPB's interim final rule which amends certain provisions of Regulation Z to broaden the class of creditors operating in rural and underserved areas that may be eligible to originate balloon-payment qualified mortgages (QMs). See an additional "Special Focus" article regarding Wisconsin's new Uniform Fiduciary Access to Digital Assets Act. Next, turn to "Regulatory Spotlight" for a notice issued by CFPB regarding the resubmission of credit card agreements to CFPB. Finally, see "Compliance Notes" for an announcement regarding changes to the Wisconsin Supreme Court's SCR 20:1.15 that will expand the use of electronic transactions in lawyer trust accounts beyond current limits of accepting payments for legal fees and costs, and collecting debts. ■

SPECIAL FOCUS

CFPB Broadens Small Creditor Operating in Rural and Underserved Areas Rules

Notice 2016-4

On **March 22, 2016**, the Bureau of Consumer Financial Protection (CFPB) issued an interim final rule to amend certain provisions of Regulation Z, which implements the Truth in Lending Act (TILA), in light of the Helping Expand Lending Practices in Rural Communities Act (HELP Act or Act).

The HELP Act broadened the class of creditors that may be eligible under TILA for the special provisions allowing origination of balloon-payment qualified mortgages (QMs) and balloon-payment high cost mortgages and for an exemption from the requirement to establish an escrow account for higher-priced mortgage loans (HPMLs) because the Act removed the term "predominately" from certain TILA sections. This article outlines these revisions to Regulation Z.

Small Creditor Balloon-Mortgage QMs and Balloon-Mortgage High Cost Loans

Prior to the interim final rule, effective April 1, 2016, only small creditors that: (1) meet the asset size threshold; (2) meet the loan origination limit; and (3) operate "predominately" in rural or underserved areas could originate balloon mortgage loans that have QM-status. Predominately has been interpreted by CFPB to mean that at least 50 percent of a creditor's covered mortgage loans were on properties located in rural or underserved areas.

However, as a result of the HELP Act and interim final rule, a small creditor will no longer be required to extend more than 50 percent of its covered transactions secured by first-liens on properties located in rural or underserved areas in order to be eligible to originate balloon-payment QMs and balloon-payment high cost mortgages. Thus, effective **March 31, 2016**, small creditors can originate balloon mortgage loans that have QM-status if they: (1) meet the asset size threshold; (2) meet the loan origination limit; and (3) originate <u>at least one</u> covered transaction secured by a first-lien on a property located in a rural or underserved area within the preceding calendar year, or, if the application for the transaction was received *before* April 1 of the calendar year, during either of the two preceding calendar years.

The interim final rule makes no other changes to the conditions creditors must currently meet to be considered a small creditor in order to be eligible to originate balloon-payment QMs and balloon-payment high cost loans.

The interim final rule retains the changes CFPB made to Regulation Z in September 2015 which created a "grace period" for applications received by April 1st of the current calendar year; CFPB created the grace period to allow a creditor some flexibility in determining eligibility for small creditor status.

Under the September 2015 changes to Regulation Z, the general rule of whether the rural-or-underserved test is satisfied depends on the creditor's activity during the preceding calendar year. However, if the application for the loan in question was received *before* April 1 of the current calendar year, the creditor may instead meet the rural-or-underserved test based on its activity during the next-to-last calendar year.

The following are examples to illustrate the applicability of the interim final rule with the grace period established under the September 2015 Regulation Z changes:

> If a creditor extended during 2017 <u>at least one</u> first-lien covered transaction that is secured by property that is located in an area that meets the definition of rural or underserved, the creditor meets this element of the exception for any transaction consummated during 2018.
>
> Alternatively, if the creditor did not extend in 2017 a transaction that meets the definition of rural or underserved test, the creditor satisfies this criterion for any transaction consummated during 2018 for which it received the application *before* April 1, 2018 if it extended during 2016 <u>at least one</u> first-lien covered transaction that is secured by a property that is located in an area that meets the definition of rural or underserved under Regulation Z.

Exemption for Small Creditors to Establish Escrow Accounts for HPMLs

Regulation Z currently provides that an escrow account need not be established for an HPML secured by a first-lien on a consumer's principal dwelling made by small creditors that meet four conditions: (1) asset size threshold; (2) loan origination limit; (3) operate "predominately" in rural or underserved areas; and (4) not maintain an escrow account for any extension of consumer credit secured by real property or a dwelling that the creditor or its affiliates currently services, other than escrow accounts established for: (a) first-lien HPMLs for applications received between April 1, 2016 and January 1, 2016; or (b) accommodation to distressed consumers to assist them in avoiding default or foreclosure.

Similar to the balloon-mortgage loan rules outlined above, as a result of the HELP Act, the interim final rule removes from the third condition listed immediately above that a small creditor must operate "<u>predominately</u>" in rural or underserved area. Also, CFPB has revised the current January 1, 2016 date, in the fourth condition listed immediately above, to extend the excluded period to May 1, 2016 to accommodate creditors who established escrow accounts after January 1, 2016 to comply with the previous requirement.

Thus, effective **March 31, 2016**, an escrow account need not be established for an HPML secured by a first-lien on a consumer's principal dwelling made by small creditors that meet four conditions: (1) asset size threshold; (2) loan origination limit; (3) originate <u>at least one</u> covered transaction secured by a first-lien on a property located in a rural or underserved area within the preceding calendar year, or, if the application for the transaction was received *before* April 1 of the calendar year, during either of the two preceding calendar years; and (4) not maintain an escrow account for any extension of consumer credit secured by real property or a dwelling that the creditor or its affiliates currently services, other than escrow accounts established for: (a) first-lien HPMLs for applications received between April 1, 2016 and <u>May 1, 2016</u>; or (b) accommodation to distressed consumers to assist them in avoiding default or foreclosure.

The interim final rule makes no other changes to the current conditions creditors must meet to be considered a small creditor exempt from the requirement to establish an escrow account for an HPML secured by a first-lien on a consumer's principal dwelling.

Technical Amendment for Application of Designation of Rural Area

The interim final rule also revises Regulation Z to make a technical amendment to insert a reference to rural areas designated through the recently created application process mandated by the HELP Act. On **March 3, 2016**, CFPB issued a final rule which established an application process under which a person may apply to have an area designated by CFPB as rural for purposes of Regulation Z. The application process is effective only through **December 4, 2017**; more detailed information about the application process may be pulled from: <u>https://www.gpo.gov/fdsys/pkg/FR-2016-03-03/pdf/2016-04643.pdf</u>.

Summary

CFPB has issued an interim final rule to implement changes made by the HELP Act to broaden the rules used to determine whether a creditor qualifies as a small creditor operating in rural or underserved areas under certain Regulation Z mortgage rules. The HELP Act removed the term "predominately" from several sections of TILA.

As a result of the HELP Act and interim final rule, a small creditor is no longer required to extend more than 50 percent of its covered loans secured by first-liens on properties located in rural or underserved areas in order to be eligible to originate balloon-payment QMs and balloon-payment high costs mortgages and for an exemption from the requirements to establish an escrow

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account for HPMLs secured by a first-lien on a consumer's principal dwelling. The interim final rule is effective **March 31, 2016**; comments are due **April 25, 2016**. The interim final rule may be found at: http://www.consumerfinance.gov/newsroom/cfpb-rule-broadens-qualified-mortgage-coverage-of-lenders-operating-in-rural-and-underserved-areas/ and http://www.consumerfinance.gov/regulatory-implementation/title-xiv/.

Wisconsin's Uniform Fiduciary Access to Digital Assets Act

Notice 2016-5

2015 Wisconsin Act 300 was recently signed into law. Act 300, which became effective **April 1, 2016**, creates Wisconsin's Uniform Fiduciary Access to Digital Assets Act (UFADAA).

UFADAA is a uniform law which modernizes fiduciary law for the Internet Age to provide default provisions related to a fiduciary's right to access digital assets. Collectively, a person's digital property and electronic communications are referred to as "digital assets." Wisconsin has modified this term to "digital property" to better incorporate UFADAA into existing Wisconsin statutory language and case law. The new law provides legal authority to fiduciaries to manage digital property in accordance with a user's trust, power of attorney (POA), or estate plan. Without UFADAA, fiduciaries could be subject to claims of unauthorized access to digital property in violation of federal law, including the Copyright Act, Electronic Communications Privacy Act (ECPA), and other cyber- and privacy-related laws. Additionally, Wisconsin's existing fiduciary laws did not neatly address management of digital property.

Act 300 revises several state statutes to incorporate UFADAA into Wisconsin's various fiduciary laws, including: Chapter 54 regarding the authority of guardians and conservators; Chapter 244 regarding the authority of an agent under a POA; Chapter 701 regarding the authority of a trustee under Wisconsin's Uniform Trust Code; and Chapters 851 and 853 regarding the authority of personal representatives as it relates to probate and wills. All fiduciary duties that apply to tangible personal property apply to digital property, including the duty of care, duty of loyalty, and the duty of confidentiality.

The Act applies to a custodian only if the user resides in Wisconsin or resided in Wisconsin at the time of the user's death. Act 300 does not apply to digital property of an employer used by an employee in the ordinary course of the employer's business.

While Act 300 mainly impacts courts who grant fiduciaries authority to act on behalf of another and practitioners who draft trusts, wills, and POAs, financial institutions need be aware of the Act in the event an institution need react to a request by a fiduciary who seeks access to digital property. This article highlights key provisions of Act 300 that may be relevant to financial institutions.

Select Definitions

The following are select definitions from the newly created Wisconsin statute Chapter 711 titled, Digital Property:

"Account" means an arrangement under a terms of service agreement in which a custodian carries, maintains, processes, receives, or stores a user's digital property or provides goods or services to the user.

"Carries" means engages in the transmission of an electronic communication.

"Catalog of electronic communications" means information that identifies each person with which a user has had an electronic communication, the time and date of the communication, and the electronic address of the person.

"Content of an electronic communication" means information concerning the substance or meaning of a communication that satisfies all of the following: (a) the information was sent or received by a user; (b) the information was electronically stored by a custodian that provides an electronic communication service to the public or is carried or maintained by a custodian that provides a remote computing service to the public; and (c) the information is not readily accessible to the public.

"Custodian" means a person that carries, maintains, processes, receives, or stores a user's digital property.

"Designated recipient" means a person chosen by the user using an online tool to administer the user's digital property.

"Digital property" means an electronic record in which a person has a right or interest. "Digital property" does not include underlying property or an underlying liability unless the property or liability is itself an electronic record.

"Electronic communication" has the meaning given in 18 USC 2510(12).

"Information" means data, text, images, videos, sounds, codes, computer programs, software, databases, or the like.

"Online tool" means a setting provided by a custodian that allows the user, by agreement between the custodian and user that is distinct from the user's assent to the terms of service, to provide directions for disclosure or nondisclosure of digital property to a designated recipient.

"User" means a person that has an account with a custodian.

account for HPMLs secured by a first-lien on a consumer's principal dwelling. The interim final rule is effective **March 31, 2016**; comments are due **April 25, 2016**. The interim final rule may be found at: http://www.consumerfinance.gov/newsroom/cfpb-rule-broadens-qualified-mortgage-coverage-of-lenders-operating-in-rural-and-underserved-areas/ and http://www.consumerfinance.gov/regulatory-implementation/title-xiv/.

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While Act 300 mainly impacts courts who grant fiduciaries authority to act on behalf of another and practitioners who draft trusts, wills, and POAs, financial institutions need be aware of the Act in the event an institution need react to a request by a fiduciary who seeks access to digital property. This article highlights key provisions of Act 300 that may be relevant to financial institutions.

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"Online tool" means a setting provided by a custodian that allows the user, by agreement between the custodian and user that is distinct from the user's assent to the terms of service, to provide directions for disclosure or nondisclosure of digital property to a designated recipient.

"User" means a person that has an account with a custodian.

Specific Authority Created by Act 300

Act 300 creates authority for a personal representative, agent, trustee, and guardian or conservator (collectively, a fiduciary) to have access to digital property. In some instances the Act also allows a fiduciary to terminate an account. The Act: (1) clarifies the scope of a custodian's terms of service agreement; (2) creates a priority-system to address contrary directions regarding disclosure of digital property to a fiduciary; (3) creates a process to allow a fiduciary to request disclosure of digital property *other than* content of an electronic communication of a user; (4) creates a separate process which requires a custodian to disclose to a fiduciary the content of an electronic communication of a user; and (5) describes how a custodian may comply with a request to disclose digital property made by a fiduciary.

Both UFADAA and Act 300 make a distinction between: (a) a fiduciary's request that a custodian disclose digital property *other than* content of an electronic communication; and (b) disclosure of content of an electronic communication to a fiduciary. This distinction is necessary because ECPA generally requires a custodian to first obtain consent of the user, addressee or intended recipient of an electronic communication before it can disclose content of an electronic communication to someone other than the addressee or intended recipient of the electronic communication. For example, if an agent requests a custodian for access to a principal's virtual currency, the agent need follow the process Act 300 has created for the disclosure of digital property *other than* content of an electronic communication. Virtual currency, while considered digital property, is not considered content of an electronic communication. If, however, an agent requests a custodian to disclose the subject line and body of a user's email message, the agent need follow the separate process Act 300 created regarding the disclosure of *content of an electronic communication* because the subject line and body of a user's email message is considered "content of an electronic communication". These two separate processes are further discussed below.

<u>Terms of Service Agreement</u>

Under the Act, a terms of service agreement is an agreement that controls the relationship between a user and a custodian. Act 300 does not change or impair the rights of a custodian or a user under a terms of service agreement to access or use digital property. The Act also does not give a fiduciary any other rights than the rights held by the user for whom the fiduciary acts or represents.

<u>User Directions for Disclosure of Digital Property</u>

Many custodians offer online tools that allow its users to direct: (a) who can have access to the user's digital property; and (b) what property is to be disclosed or not disclosed. To avoid contradictions between the terms of a custodian's online tool and terms of a user's trust, POA, or estate plan, Act 300 creates a three-tiered priority system regarding the disclosure of digital property. A user may use an online tool to direct the custodian to disclose to a designated recipient or not to disclose some or all of the user's digital property—including the content of electronic communications. If the online tool allows the user to modify or delete a direction at all times, a direction regarding disclosure using an online tool overrides a contrary direction by the user in a trust, POA, will, or any other governing instrument.

If a user has not used an online tool to give direction, or if the custodian has not provided an online tool, the user may allow or prohibit disclosure to a fiduciary of some or all of the user's digital property, including the content of electronic communications sent or received by a user, in a will, trust, POA or any other governing instrument.

A user's direction as outlined above overrides a contrary provision in a terms of service agreement that does not require the user to act affirmatively and distinctly from the user's assent to the terms of service.

<u>Disclosure of Digital Property Other than Content of Electronic Communications</u>

Act 300 sets forth the conditions under which a custodian is required to disclose digital property *other than* content of electronic communications, including a catalog of electronic communications, to a fiduciary if the fiduciary provides certain information to the custodian. What information is to be provided to the custodian depends upon the type of fiduciary asking for disclosure.

To disclose to an agent, the agent must provide the custodian: (1) a written request for disclosure in physical or electronic form; (2) an original or copy of the POA that gives the agent specific authority over digital property or general authority to act on behalf of the principal; (3) a certification by the agent that the POA is in effect; and (4) if requested by the custodian, any of the following: (a) a number, username, address, or other unique identifier assigned by the custodian to identify the principal's account, or (b) evidence linking the account to the principal.

To disclose to a trustee, the trustee must provide the custodian: (1) a written request for disclosure in physical or electronic form; (2) a certification of trust; (3) a certification by the trustee that the trust exists and the trustee is a currently acting trustee of the trust; and (4) if requested by the custodian, any of the following: (a) a number, username, address, or other unique identifier assigned by the custodian to identify the trust's account, or (b) evidence linking the account to the trust.

To disclose to a guardian or conservator, the guardian or conservator must provide the custodian: (1) a written request for disclosure in physical or electronic form; (2) a certified copy of the court order that gives the guardian or conservator authority over the protected person's digital property; and (3) if requested by the custodian, any of the following: (a) a number, username, address, or other unique identifier assigned by the custodian to identify the ward's account, or (b) evidence linking the account to the protected person.

To disclose to a personal representative of a deceased user's estate, the personal representative must provide to the custodian: (1) a written request for disclosure in physical or electronic form; (2) a certified copy of the death certificate of the user; (3) a copy of the document which establishes the personal representative's authority over the deceased user's estate; and (4) if requested by the custodian, any of the following: (a) a number, username, address, or other unique identifier assigned by the custodian to identify the deceased user's account; (b) evidence linking the account to the deceased user; (c) an affidavit stating that disclosure of the deceased user's digital property is reasonably necessary for administration of the estate; or (d) a court order that includes a finding that the deceased user had a specific account with the custodian, or a court order that includes a finding the disclosure of the deceased user's digital property is reasonably necessary for administration of the estate.

The type of document that can be presented that establishes the personal representative's authority over the deceased user's estate includes: (a) a certified copy of the letters of appointment of the personal representative or special administrator; (b) a certified copy of a summary proceeding order under statutory sections 867.01 or 867.02; (c) an original or copy of a transfer by affidavit under section 867.03; or (d) an original or copy of an application for summary confirmation of interest in property under section 867.046.

<u>Disclosure of Content of Electronic Communications</u>

In some instances the authority created by Act 300 requires a custodian to disclose to a fiduciary the content of an electronic communication; the content of an electronic communication includes the subject line of a user's email message, text message, or other message between private parties.

As mentioned above, Act 300 makes a distinction between the disclosure of "content of an electronic communication" and "disclosure of digital property *other than* content of electronic communication" because an electronic communication is a specific type of digital asset that is subject ECPA. Under ECPA, a custodian may divulge the contents of electronic communications only: (1) to an addressee or intended recipient of the communication or agent of such addressee or intended recipient; or (2) with the lawful consent of the originator or an addressee or intended recipient of the communication.

So as to not violate ECPA, Act 300 sets forth conditions under which a custodian is required to disclose the content of electronic communications to a fiduciary if the fiduciary provides certain information to the custodian. The information required to be provided to a custodian is similar to that which is outlined above regarding the disclosure of digital property *other than* content of an electronic communication but also includes proof of the user's consent for disclosure of content of electronic communications. Proof of the user's consent may consist of a: (1) document which proves the user consented to the disclosure of content of electronic communications; (2) POA which expressly grants an agent authority over content of electronic communications; (3) certification of trust that includes an original or successor user's consent to disclosure of content of electronic communications to the trustee; or (4) court order which directs the custodian to disclose contents of electronic communications, as applicable.

Choice of Methods for Disclosing Digital Property

When disclosing digital property of a user, the custodian may in its sole discretion provide a fiduciary or designated recipient with any of the following: (1) full access to the user's account; (2) partial access to the user's account that is sufficient to perform the tasks with which the fiduciary or designated recipient is charged; or (3) a copy in a record of any digital property that the user could have accessed if the user were alive, had full capacity, and had full access to the account on the date on which the custodian received the request for disclosure.

In providing access, the custodian may assess a reasonable administrative charge to a fiduciary or designated recipient for the cost of disclosing digital property under the Act. The custodian has 60 days after receipt of the information required to be provided the custodian to comply with the request from a fiduciary. A custodian and its officers, employees, and agents are immune from liability for an act or omission done in good faith in compliance with Act 300.

Summary

Wisconsin has recently enacted UFADAA to modernize fiduciary law for the Internet Age to provide default provisions related to a fiduciary's right to access digital property.

2015 Wisconsin Act 300: (1) clarifies the scope of a custodian's terms of service agreement; (2) creates a priority-system to address contrary directions regarding disclosure of digital property to a fiduciary; (3) creates a process to allow a fiduciary to request disclosure of digital property *other than* content of an electronic communication of a user; (4) creates a separate process which requires a custodian to disclose to a fiduciary content of an electronic communication of a user; and (5) describes how a custodian may comply with a request from a fiduciary for disclosure of digital property. Act 300 became effective **April 1, 2016** and may be found at: http://docs.legis.wisconsin.gov/2015/related/acts/300.pdf. ■

REGULATORY SPOTLIGHT

CFPB Issues Interim Final Rule to Broaden the Small Creditor Operating in Rural and Underserved Areas Rule.

The Bureau of Consumer Financial Protection (CFPB) has issued an interim final rule to amend certain provisions of Regulation Z in light of title LXXXIX of the Fixing America's Surface Transportation Act, entitled the Helping Expand Lending Practices in Rural Communities Act. The amendments to Regulation Z concern two matters: (1) the eligibility of certain small creditors that operate in rural or underserved areas for special provisions that permit the origination of balloon-payment qualified mortgages and balloon-payment high cost mortgages and for an exemption from the requirement to establish an escrow account for higher-priced mortgage loans; and (2) the determination of whether an area is rural for the purposes of Regulation Z. The final rule is effective on **03/31/2016**. Comments are due **04/25/2016**. Copies of the interim final rule may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-03-25/pdf/2016-06834.pdf. *Federal Register*, Vol. 81, No. 58, 03/25/2016, 16074-16084.

CFPB Issues Notice Regarding Submission of Credit Card Agreements.

CFPB has issued a notice regarding the submission of credit card agreements under the Truth in Lending Act (TILA) and Regulation Z. Credit card issuers are required to submit their currently-offered credit card agreements to CFPB; CFPB posts the agreements on its website. In April 2015, CFPB suspended the submission obligation for a period of one year. The suspension period has expired, and the next submission is due on the first business day on or after **04/30/2016**. Instructions regarding how to submit credit card agreements may be found on CFPB's website. Credit card issuers are required to submit to CFPB the agreements they offered to the public as of **03/31/2016**, on or before **05/02/2016**. Copies of the notice may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-04-05/pdf/2016-07815.pdf. *Federal Register*, Vol. 81, No. 65, 04/05/2016, 19467.

CFPB Seeks Comment on New Information Collection Regarding Regulation I.

CFPB seeks comment on a new information collection entitled, Regulation I: Disclosure Requirements for Depository Institutions Lacking Federal Deposit Insurance. Regulation I applies to all depository institutions lacking federal deposit insurance. It requires the disclosure of certain insurance-related information in periodic statements, account records, locations where deposits are normally received, and advertising. The regulation also requires such depository institutions to obtain a written acknowledgment from depositors regarding the institution's lack of federal deposit insurance. On **12/16/2011**, CFPB issued an interim final rule to republish Regulation I making technical and conforming changes to reflect the transfer of authority and certain other changes made by the Dodd-Frank Act. CFPB has determined that the disclosures required by sections 1009.3 and 1009.4 of Regulation I and the signed acknowledgment required by section 1009.5 are subject to the Paperwork Reduction Act and requires Office of Management and Budget approval. Comments are due **05/23/2016**. Copies of the notice may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-03-23/pdf/2016-06469.pdf. *Federal Register*, Vol. 81, No. 56, 03/23/2016, 15509-15510.

FRB Issues Proposed Rule on Single-Counterparty Credit Limits for Large Banking Organizations.

The Board of Governors of the Federal Reserve System (FRB) has issued a proposed rule that would establish single-counterparty credit limits for domestic and foreign bank holding companies with $50 billion or more in total consolidated assets. The proposed rule would implement section 165(e) of the Dodd-Frank Act, which requires FRB to impose limits on the amount of credit exposure that such a domestic or foreign bank holding company can have to an unaffiliated company in order to reduce the risks arising from the company's failure. The proposed rule would increase in stringency based on the systemic importance of the firms to which they apply. Comments are due **06/03/2016**. Copies of the proposed rule may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-03-16/pdf/2016-05386.pdf. *Federal Register*, Vol. 81, No. 51, 03/16/2016, 14328-14364.

FRB Issues Proposed Rule to Clarify Risk-Based Capital Guidelines for Certain Bank Holding Companies.

FRB has issued a proposed rule to clarify rules regarding risk-based capital surcharges for U.S. based global systemically important bank holding companies (GSIB

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Read "Special Focus" for an article regarding recent changes to Wisconsin's foreclosure and abandoned property laws. Next, turn to "Judicial Spotlight" for an article on a federal court's approval of a Wisconsin bank's practice to take and perfect its lien of a seller's interest in a land contract and another article regarding a recent Wisconsin Supreme Court ruling of whether unpaid previously assessed condominium association dues could survive foreclosure of the property. Then, turn to "Regulatory Spotlight" for CFPB's proposed rule regarding arbitration agreements. Finally, see "Compliance Notes" for a reminder that financial institutions are eligible for a limited liability exemption from environmental liability under Wisconsin's Hazardous Substance Discharge Law (Spill Law) under certain conditions. ■

SPECIAL FOCUS

Updates to State and Federal Foreclosure and Abandoned Property Laws.

Notice 2016-6

Wisconsin has recently made changes to its foreclosure law to shorten the redemption period for 1-4 family residential property; the redemption period is the period of time a borrower has to repay the outstanding obligation in order to keep, or redeem, the property. Additionally, Wisconsin's abandoned property law has been revised to incorporate recent Wisconsin Supreme Court rulings. This article highlights: (1) recent changes to Wisconsin's foreclosure and abandoned property laws; and (2) FDIC's supervisory expectation for institutions that discontinue foreclosure proceedings, commonly referred to as abandoned property.

State Law

2015 Wisconsin Act 376 makes revisions to Wisconsin's foreclosure and abandoned property laws. The changes made to the state's foreclosure laws apply to 1-4 family residential property. The changes made to the state's abandoned property law apply to both residential and commercial property.

Prior to the recent changes, the redemption period for 1-4 family residential property was twelve months from the date when the judgment was entered in a foreclosure when deficiency was not waived. For a mortgage executed on or after **April 27, 2016**, Act 376 reduces the twelve-month period to six months. If the borrower is attempting in good faith to sell the property and has entered into a listing agreement with a licensed real estate agent for sale, the redemption period is extended to eight months.

The redemption period for 1-4 family residential property was six months from the date when the judgment was entered in a foreclosure when deficiency was waived. For a mortgage executed on or after **April 27**, **2016**, Act 376 reduces the six-month period to three months. If the borrower is attempting in good faith to sell the property and has entered into a listing agreement with a licensed real estate agent for sale, the redemption period is extended to five months. To incorporate a recent Wisconsin Supreme Court ruling, Act 376 also clarifies that, in an action for which deficiency is waived, the notice of foreclosure sale of a 1-4 family residential property *may* be given during the redemption period.

As mentioned above, Act 376 also revises Wisconsin's abandoned property law. In a recent Wisconsin Supreme Court ruling, the court interpreted section 846.102 Wis. Stats. to permit any party and a municipality to move that a property be deemed abandoned, and required the sale of an abandoned premises be made as soon as reasonable upon expiration of the five-week redemption period. The court did not define a specific period of time for what it meant by "as soon as reasonable" and instead left it for courts to interpret on a case-by-case basis dependent upon the facts and circumstances of a particular abandoned property situation.

Act 376 has revised sec. 846.102 so that only the plaintiff or municipality can move that a property be deemed abandoned by a court. Additionally, Act 376 requires a plaintiff to take one of the following actions regarding the abandoned property within twelve months after the foreclosure judgment was entered and the five-week redemption period: (1) hold a sale of the mortgaged premises and have the sale confirmed; or (2) release or satisfy the mortgage lien and vacate the judgment of foreclosure. If neither of these actions occur, any party may petition the court to order the sale of the premises.

Federal Law

On **March 2, 2016**, the Federal Deposit Insurance Corporation (FDIC) issued a Financial Institution Letter (FIL) to clarify supervisory expectations in existing guidance for institutions' risk-management practices for decisions to discontinue foreclosure proceedings after initiating such actions. This practice is commonly referred to as abandoned foreclosures. FDIC stated in its guidance that it continues to encourage financial institutions to avoid unnecessary foreclosures by working constructively with the borrower(s) and considering prudent workout arrangements that increase the potential for financially stressed borrowers to keep their properties.

FDIC further stated that when workout arrangements are unsuccessful or not economically feasible, existing FDIC guidance reminds institutions of the need to establish policies and procedures for acquiring other real estate that mitigate the impact the foreclosure process has on the value of surrounding properties. Institutions that initiate the foreclosure process may subsequently decide to discontinue the proceedings based on financial considerations, such as a determination that the costs to foreclose, rehabilitate, and sell a property exceed its current market value. When such decisions are made after institutions have initiated foreclosure, the borrower(s) may have already abandoned or stopped maintaining the property. Such properties can lead to blight, crime or an accumulation of trash, causing a negative effect on neighboring properties and the local communities.

FDIC stated in the FIL that institutions should have appropriate policies and practices pertaining to the decision to discontinue the foreclosure process that address:

- *Obtaining and Assessing Current Information*. FDIC has instructed that institutions should obtain the best practicable information on the market value of real estate subject to foreclosure and use current valuation and other relevant information to assess whether to initiate, pursue, or abandon a foreclosure proceeding.

- *Releasing Lien(s)*. Because institutions that forego foreclosure due to financial considerations may face, in some instances, potential litigation risk arising from their position as a mortgagee of a now-abandoned property, FDIC recommends institutions should implement criteria for determining when their lien(s) should be released.

- *Notifying Local Authorities*. Institutions are reminded to notify appropriate state or local government authorities, such as tax authorities, courts, or code enforcement departments, of decisions to no longer pursue a foreclosure. Institutions must also comply with applicable state or local government authorities' notification requirements.

- *Notifying the Borrower(s)*. Institutions are reminded to notify the borrower(s) when a decision is made to discontinue a foreclosure action. The notices should inform the borrower(s) that the: (1) mortgage holder is no longer pursuing foreclosure; (2) mortgage holder has or has not released the lien; (3) borrower has the right to occupy the property until a sale or other title transfer action occurs; (4) borrower remains financially obligated for the outstanding loan balance, real estate and other applicable taxes, homeowners association dues, and insurance premiums; and (5) borrower is responsible for maintaining the property in accordance with all state and local laws, codes, and ordinances.

- *Contacting the Borrower(s)*. FDIC has also instructed that institutions should use reasonable means, including methods similar to those to contact the borrower(s) in connection with payment collection activities, to provide the notice described above—particularly to borrower(s) who vacated their property based on the institutions' communications regarding the initiation of foreclosure action.

Financial institutions should expect FDIC to review an institution's discontinuation process in examinations. FDIC's supervisory activities will include a review of institutions' policies and practices related to foreclosure proceedings, including determinations to discontinue such actions. During safety and soundness examinations, FDIC has instructed that examiners will review an institution's analysis for supporting decisions to initiate, pursue, or discontinue foreclosure actions; decisions to release liens; and management reports on these activities.

FDIC has also instructed that during consumer protection exams, examiners will review the actions taken by institutions to contact the borrower(s) and whether notices to the borrower(s) and local authorities regarding the institution's decision to discontinue a foreclosure proceeding—including the information described above—where provided in a manner that complies with applicable state or local government authorities' notification requirements. Lastly, FDIC has instructed that consumer protection examiners will also review whether institutions' consumer inquiry and complaint process adequately address concerns raised regarding abandoned foreclosures.

WBA COMPLIANCE JOURNAL is published by the **Wisconsin Bankers Association**, 4721 South Biltmore Lane, P.O. Box 8880, Madison, Wisconsin, 53708-8880. **Senior Writers:** Kristine Cleven, Heather MacKinnon and Scott Birrenkott. **Editor:** Kelly Kallien. **Subscription Rate:** $195/year for non-members. For subscription orders and inquiries, please contact the Wisconsin Bankers Association at the above address, by phone at 608/441-1200, by fax at 608/661-9381, or e-mail at wbalegal@wisbank.com. ***WBA COMPLIANCE JOURNAL*** can be seen on the Web at: www.wisbank.com.

Summary

Effective for mortgages filed on or after **April 27, 2016**, Wisconsin now has shorter redemption period for 1-4 family residential property. Wisconsin law regarding abandoned property has also been revised to incorporate recent Wisconsin Supreme Court rulings. Separately, FDIC has issued an FIL to clarify its supervisory expectations for financial institutions dealing with abandoned property. 2015 Wisconsin Act 376 may be found at: http://docs.legis.wisconsin.gov/2015/related/acts/376.pdf. FDIC's FIL may be found at: https://www.fdic.gov/news/news/financial/2016/fil16014.pdf. ■

JUDICIAL SPOTLIGHT

Federal Court Approves Practice That Allowed A Wisconsin State Bank To Take And Perfect Assignment Of Seller's Interest In Land Contract For Collateral Purposes.

Notice 2016-07

The United States Court of Appeals for the Seventh Circuit, which Circuit includes Wisconsin, recently interpreted Wisconsin law and approved the practice followed by a Wisconsin state bank to take and perfect its lien on a seller's interest in a land contract. The case is *Blanchards, Debtors, and Liebzeit, Trustee in Bankruptcy, v. Intercity State Bank*, Case No. 14-C-1527, decided by the Court on April 14, 2016. This Court decision may be instructive to other Wisconsin banks when taking similar collateral to secure loans. However, it is also important for Wisconsin banks to understand that the favorable interpretation of Wisconsin law by the Federal Court in this case may be persuasive with state courts in Wisconsin but is not binding as precedent. A Wisconsin state court could conceivably reach a different decision under the same or similar facts.

<u>The Facts</u>

The Blanchards sold a residential property in Marathon County on land contract and accepted a partial payment upfront of $30,000 from the buyer. As agreed by the Blanchards and the buyer, the Blanchards then obtained a mortgage loan of $142,000 from the Bank using the same property as collateral to indirectly receive the payment of the remainder of the purchase price. So, under the terms of the land contract, the Blanchards received money immediately from the down payment paid by the buyer and the proceeds of the mortgage loan made by the seller's Bank. The mortgage was recorded in the real estate records.

The Bank did not obtain a separate specific assignment of the land contract for collateral purposes relying instead on the description of collateral in its recorded mortgage to include the seller's interest in the land contract as additional collateral. The Bank used a WBA 428 Real Estate Mortgage which includes broad language to describe the property subject to the mortgage. According to the WBA 428 Real Estate Mortgage used by the Bank, the Blanchards agreed to mortgage the described property to the Bank and granted a mortgage lien on "all privileges, hereditaments, easements and appurtenances, all rents, leases, issues and profits, all claims, awards and payments made as a result of the exercise of the right of eminent domain, all existing and future improvements and all goods that are or are to become fixtures." Clearly, this is a long legal description of collateral subject to the mortgage, but in this case this long legal description of collateral subject to the mortgage allowed the Court to declare that the seller's interest in the land contract is sufficiently described by the mortgage and to declare the Bank the winner in this case.

The Bank also did not file a UCC financing statement with DFI, again relying instead on its recorded mortgage to perfect its interest in the seller's interest in the land contract as additional collateral.

A few years after the transaction described above, the Blanchards filed for bankruptcy, and the trustee in bankruptcy attempted to step ahead of the Bank's recorded mortgage so that it could use the seller's interest in the land contract as an asset for the benefit of unsecured creditors. In support of the trustee's attempt to knock out the Bank's mortgage, the trustee argued that the mortgage could attach only to real property and that the seller's interest in the land contract was personal property and therefore could not be subject to a recorded real estate mortgage. The trustee also argued that the Bank never attached a lien to the personal property consisting of the seller's interest in the land contract and therefore the seller's interest in the land contract should be available to the trustee for the benefit of unsecured creditors.

The Court had to answer three primary questions:

1. Is the seller's interest as a vendor under a land contract a proper subject of a mortgage to secure the Bank's loan to the seller?

2. Is the collateral description in the WBA Real Estate Mortgage used by the Bank broad enough to include the seller's interest in the land contract as additional collateral even without a description of the specific land contract in the mortgage?

3. Under Wisconsin law, is a mortgage recorded in the real estate records effective for the Bank to perfect a lien on a seller's interest in a land contract rather than by filing a UCC financing statement with DFI?

Wisconsin Bankers ASSOCIATION

Compliance Journal

Special Focus

Supreme Court Expands E-Banking in Lawyer Trust Accounts

Notice 2016-09

In recognition of the shift from check-driven banking to electronic banking, the Wisconsin Supreme Court has authorized lawyers to utilize electronic banking to conduct trust account transactions. As of **07/01/2016**, lawyers can establish a new type of IOLTA account, called an "E-Banking Trust Account" or convert an existing Credit Card Trust Account to an E-Banking Trust Account.

Lawyers will also have the option of conducting electronic transactions in an IOLTA account that is not an E-Banking IOLTA, provided that certain safeguards are in place. The required safeguards include: (1) commercially reasonable account security for electronic transactions; (2) a bond or crime insurance policy sufficient to cover the account's maximum daily balance for the prior year; and (3) all chargebacks, ACH reversals, monthly account fees and fees deducted from deposits are deducted from the lawyer's business account or any and all funds withdrawn by the financial institution or card issuer are replaced within three business days after receiving notice of a chargeback, surcharge, etc.

While lawyers have been able to accept legal fees and costs via credit card, debit card and other electronic transactions since 2007, they have been prohibited from initiating electronic transactions from a trust account and from conducting electronic transactions for purposes other than accepting legal fees and performing collection work. Under the new trust account rule, electronic payments can be sent or received for virtually any purpose, subject to the requirements of **SCR 20:1.15(f)(1) and (3)**. The new rule also permits remote deposits to an IOLTA account, regardless of whether it is an E-Banking IOLTA.

In order to conduct an electronic transfer from a trust account, a lawyer will need to record certain information in the financial institution's electronic payment system. The required information includes: the date, amount, payee, client matter and reason for the disbursement.

Finally, not all electronic transactions are permitted. The new rule prohibits lawyers from making disbursements from a trust account by credit card, debit card, prepaid or other types of payment cards or by any type of electronic payment system that does not generate a record of the date, amount, payee, client matter and reason for the disbursement in the financial institution's electronic payment system.

For further information, go to: www.wicourts.gov/courts/offices/olrfinancial.htm.

WBA wishes to thank Ms. Mary Hoeft Smith, Program Adminsistrator, Trust Account Program, Office of Lawyer Regulation, for providing this article.

Implementation of the New E-Banking Lawyer Trust Account Rule

Notice 2016 - 10

Wisconsin Supreme Court Rule (SCR) 20:1.15 has been rewritten to incorporate changes relating to electronic transactions. As indicated by the Office of Lawyer Regulation (OLR) in the previous article, effective **July 1, 2016**, lawyers may now conduct electronic transactions on an IOLTA account or may establish a separate IOLTA account known as an E-Banking Trust Account. This capability carries additional security requirements, restricted transactions, and reporting requirements. However, those requirements are, in large part, the duty and responsibility of the lawyer maintaining the account rather than the financial institution where the account is established. This article will focus on the new rule's additional requirements related to financial institutions.

Definitions

The following definitions are important to understanding the function of the rule and have been updated to include "electronic transaction."

Wisconsin Bankers ASSOCIATION

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Special Focus

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While lawyers have been able to accept legal fees and costs via credit card, debit card and other electronic transactions since 2007, they have been prohibited from initiating electronic transactions from a trust account and from conducting electronic transactions for purposes other than accepting legal fees and performing collection work. Under the new trust account rule, electronic payments can be sent or received for virtually any purpose, subject to the requirements of **SCR 20:1.15(f)(1) and (3)**. The new rule also permits remote deposits to an IOLTA account, regardless of whether it is an E-Banking IOLTA.

In order to conduct an electronic transfer from a trust account, a lawyer will need to record certain information in the financial institution's electronic payment system. The required information includes: the date, amount, payee, client matter and reason for the disbursement.

Finally, not all electronic transactions are permitted. The new rule prohibits lawyers from making disbursements from a trust account by credit card, debit card, prepaid or other types of payment cards or by any type of electronic payment system that does not generate a record of the date, amount, payee, client matter and reason for the disbursement in the financial institution's electronic payment system.

For further information, go to: www.wicourts.gov/courts/offices/olrfinancial.htm.

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Definitions

The following definitions are important to understanding the function of the rule and have been updated to include "electronic transaction."

(1) "Draft account" means an account from which funds are withdrawn through a properly payable instrument or an electronic transaction.

(2) "Electronic transaction" means a paperless transfer of funds to or from a trust or fiduciary account. Electronic transactions do not include transactions initiated by voice or automated teller or cash dispensing machines.

(3) "Fiduciary" means an agent, attorney-in-fact, conservator, guardian, personal representative, special administrator, trustee, or other position requiring the lawyer to safeguard the property of a client or 3rd party.

(4) "Fiduciary account" means an account in which a lawyer deposits fiduciary property.

(5) "Fiduciary property" means funds or property of a client or 3rd party that is in a lawyer's possession in a fiduciary capacity. Fiduciary property includes, but is not limited to, property held as agent, attorney-in-fact, conservator, guardian, personal representative, special administrator, or trustee, subject to the exceptions identified within the rule.

(6) "Interest on Lawyer Trust Account or 'IOLTA account'" means a pooled interest-bearing or dividend-paying draft trust account, separate from a lawyer's business and personal accounts, which is maintained at an IOLTA participating institution. Typical funds that would be placed in an IOLTA account include earnest monies, loan proceeds, settlement proceeds, collection proceeds, cost advances, and advanced payments of fees that have not yet been earned. An IOLTA account is subject to the provisions of SCR Chapter 13 and the trust account provisions of subs. (a) to (i), including the IOLTA account provisions of subs. (c) and (d).

(7) "IOLTA participating institution" means a financial institution that voluntarily offers IOLTA accounts and certifies to WisTAF annually that it meets the IOLTA account requirements within the rule.

(8) "Properly payable instrument" means an instrument that, if presented in the normal course of business, is in a form requiring payment pursuant to the laws of this state.

(9) "Trust account" means an account in which a lawyer deposits trust property.

(10) "Trust property" means funds or property of clients or 3rd parties that is in a lawyer's possession in connection with a representation, which is not fiduciary property.

(11) "WisTAF" means the Wisconsin Trust Account Foundation, Inc.

Practical Aspects

While the rule has been rewritten much of its substance remains the same. Aside from technical changes, one of the primary additions to the rule that will affect financial institutions is the incorporation of electronic transactions on an IOLTA account. Thus, a financial institution's options for compliance applying to an IOLTA participating institution, allowable reasonable fees, remittance to WisTAF, and overdraft reporting requirements have not changed.

Furthermore, while the rule does incorporate requirements for security of transactions, prohibited transactions, maintenance and record-keeping requirements, insurance, and safekeeping requirements, those primarily apply to the lawyer maintaining the account. It is the responsibility of the lawyer establishing and acting on the account to not conduct or authorize transactions that do not meet these requirements. The rule places no additional burdens on financial institutions maintaining IOLTA accounts or E-Banking Trust Accounts to monitor those accounts beyond what was previously required.

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As indicated in OLR's summary, lawyers have the option to: (1) establish an E-Banking Trust Account; (2) convert a current Credit Card Trust Account to an E-Banking Trust Account; or (3) conduct electronic transactions on an IOLTA account that is not an E-Banking Trust Account provided they meet three requirements. Those requirements are outlined in greater detail in OLR's summary of the rule.

If the lawyer wishes to establish a separate E-Banking Trust Account, the lawyer must ensure that such an account be established in addition to the primary IOLTA account. The lawyer must additionally ensure that no electronic transactions can be conducted other than those transferring funds from the primary IOLTA to the separate E-Banking Trust Account. Financial institutions should be aware that the separate IOLTA account designated for electronic transactions must include in its title: "E-Banking Trust Account."

Remote Deposits

Also under the rewritten rule, lawyers may now make remote deposits to a trust account. While the lawyer is required to keep a record related to remote deposits, when remote deposits are a possibility on a trust account, the rule <u>requires that a financial institution must maintain an image of the front and reverse of each remote deposit for a period of at least six years.</u>

Dishonored payment notification

As a reminder, all draft trust accounts, and any draft fiduciary account that is not subject to an alternative protection, are subject to the following provisions on dishonored payment notification. The provisions have been updated to include references to electronic transactions:

1. Overdraft reporting agreement. A lawyer must maintain draft trust and fiduciary accounts only in a financial institution that has agreed to provide an overdraft report to the Office of Lawyer Regulation under paragraph 2 below. A lawyer or law firm must notify the financial institution at the time a trust account or fiduciary account is established that the account is subject to the reporting requirement.

2. Overdraft report. In the event any properly payable instrument or electronic transaction is presented against or made from a lawyer trust or fiduciary account containing insufficient funds, whether or not the instrument or electronic transaction is honored, the financial institution must report the overdraft to the OLR.

3. Content of report. All reports made by a financial institution must be substantially in the following form:

    i. In the case of a dishonored instrument or electronic transaction, the report must be identical to an overdraft notice customarily forwarded to the depositor or investor, accompanied by the dishonored instrument or electronic transaction, if a copy is normally provided to the depositor or investor.

    ii. In the case of instruments or electronic transactions that are presented against insufficient funds and are honored, the report must identify the financial institution involved, the lawyer or law firm, the account, the date on which the instrument or electronic transaction is paid, and the amount of overdraft created by the payment.

4. Timing of report. The overdraft report must be made simultaneously with the overdraft notice given to the depositor or investor.

5. Confidentiality of report. A report made by a financial institution is subject to SCR 22.40: Confidentiality, which requires all papers, files, transcripts, and communications in any matter involving OLR be held in confidence by OLR.

6. Withdrawal of report by financial institution. OLR will hold each overdraft report for 10 business days to enable the financial institution to withdraw a report provided by inadvertence or mistake. The deposit of additional funds by the lawyer or law firm does not constitute reason for withdrawing an overdraft report.

7. Service charges. A financial institution may charge a lawyer or law firm for the reasonable costs of producing the reports and records required by the rule.

8. Immunity of financial institution. A claim does not automatically arise

Special Focus

against a financial institution for failure to provide a trust account overdraft report or for non-compliance with the above requirements.

Conclusion

Financial institutions should be aware that as of **July 1, 2016** SCR 20:1.15 permits lawyers to conduct electronic transactions on an IOLTA account or establish a new type of IOLTA account referred to as an "E-Banking Trust Account." While the rule does not change the previously established certification, compliance, fee, and overdraft reporting requirements, it adds additional requirements related to electronic transactions on IOLTA accounts. Those changes relevant to financial institutions are an overdraft reporting requirement for electronic transactions and a requirement to maintain an image of the front and back of each remote deposit for a period of at least six years. Financial institutions should be aware of the methods lawyers may pursue to conduct electronic transactions on existing IOLTA accounts or by which they may wish to establish an E-Banking Trust Account and have applicable policies and procedures in place.

FIPCO® is revising programming within the Compliance Concierge deposit system to accommodate the changes to the rule including a revised IOLTA overdraft agreement. Within Compliance Concierge, a new E-Banking Trust Account will automatically be titled, for example: "It's A Living, Inc., E-Banking Trust Account". Financial institutions that do not use FIPCO® software and forms should contact their vendors to ensure deposit documentation systems and overdraft agreements accommodate the new account type and permitted electronic transactions. For more details, please see the rule and additional resources at: https://www.wicourts.gov/courts/offices/docs/olrfiscal19.pdf. ■

Regulatory Spotlight

Agencies Issue Semiannual Regulatory Agendas.

- The Bureau of Consumer Financial Protection (CFPB) has published its spring 2016 semiannual regulatory agenda in the *Federal Register*. CFPB reasonably anticipates having the regulatory matters identified within the agenda under consideration during the period from **05/01/2016** through **04/30/2017**. The next agenda will be published in fall 2016 and will update the agenda through fall 2017. The information within the agenda is current as of **03/25/2016**. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-09/pdf/2016-12931.pdf. *Federal Register*, Vol. 81, No. 111, 06/09/2016, 37412-37415.

- The Board of Governors of the Federal Reserve System (FRB) has issued its semiannual regulatory agenda. FRB anticipates considering the regulatory matters indicated within the agenda during the period **05/01/2016** through **10/31/2016**. The next agenda will be published in fall 2016. Comments may be submitted anytime during the next six months. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-09/pdf/2016-12934.pdf. *Federal Register*, Vol. 81, No. 111, 06/09/2016, 37462-37463.

- The Department of Housing and Urban Development (HUD) has published its agenda of regulations already issued or that are expected to be issued during the next several months. The agenda also includes rules currently in effect that are under review and describes those regulations that may affect small entities, as required by section 602 of the Regulatory Flexibility Act. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-09/pdf/2016-12907.pdf. *Federal Register*, Vol. 81, No. 111, 06/09/2016, 37320-37321.

- The Department of the Treasury (Treasury) has issued is semiannual regulatory agenda which includes regulations that Treasury has issued or expects to issue and rules currently in effect that are under review. Copies of the agenda may be obtained from WBA or viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-09/

Wisconsin Bankers Association

Compliance Journal

Special Focus

FDIC Guidance on Identifying, Accepting and Reporting Brokered Deposits Updated - Again

Notice 2016-11

The Federal Deposit Insurance Corporation (FDIC) has once again issued guidance in the form of "Frequently Asked Questions" or 'FAQs" to promote consistency by insured depository institutions (IDIs) in identifying, accepting and reporting brokered deposits. The new FAQs were written after FDIC considered industry comments on FAQs issued in January 2015. The guidance applies to all IDIs. The FAQs may be updated periodically on FDIC's website and, when appropriate, FDIC will issue advisory opinions.

Background

It is important for IDIs to distinguish brokered deposits from other deposits to comply with Section 29 of the Federal Deposit Insurance Act (FDI Act). Under Section 29, an IDI is prohibited from accepting deposits by or through a deposit broker unless the institution is well capitalized for Prompt Corrective Action purposes. FDIC may waive the prohibition if the IDI is adequately capitalized; however, the prohibition cannot be waived if the institution is undercapitalized. Section 29 also imposes restrictions on the deposit interest rates that an IDI may offer if the institution is not well capitalized. FDIC has implemented its restrictions in Section 337.6 of its regulations.

IDIs are also responsible for reporting brokered deposits in their Consolidated Reports of Condition and Income (Call Reports); this is another reason why IDIs need be able to distinguish brokered deposits from other deposits.

FDIC defines the term "brokered deposit" as any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker. Thus, the meaning of the term "brokered deposit" depends upon the meaning of the term "deposit broker".

"Deposit broker" is defined as any person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with IDIs or the business of placing deposits with IDIs for the purpose of selling interests in those deposits to third parties. The definition is very broad; however, there are a number of exceptions to the definition. IDIs should keep in mind that, as a result of the broad definition, FDIC has cautioned that a brokered deposit may be any deposit accepted by an IDI from or through a third party, such as a person or company or organization other than the owner of the deposit. Therefore, IDIs should carefully review whether they have brokered deposits.

This article highlights select FAQs which are new or revised items from the January 2015 release. The complete guidance may be found at: www.fdic.gov/news/news/financial/2016/fil16042.html.

Placing Deposits and Facilitating the Placement of Deposits

Q1: Are insurance agents, lawyers, or accountants that refer clients to an IDI considered to be deposit brokers?

A1: It depends. FDIC recognizes that within a community, there are many business professionals that conduct banking business with a particular IDI, and due to that banking allegiance, often refer their customers to a particular IDI on an informal basis for deposit products. The deposits produced by those types of informal deposit referrals would generally not be considered brokered. The deposits would be brokered, however, in more formal, programmatic arrangements between the IDI and business professionals, such as where: (1) the professional has entered into a written agreement with the IDI for the referral of depositors; or (2) the professional receives fees from the IDI. In these cases, FDIC would generally consider the professional to have facilitated the placement of deposits in the IDI, and therefore, the deposits received by the IDI would be brokered.

Q2: What is an example of when the deposits in a programmatic arrangement to refer depositors are not brokered deposits?

A2: Some IDIs have programs where IDI customers or employees of subsidiaries or affiliates of the IDI can earn bonuses in the form of cash, merchandise, or a higher interest rate on a deposit for referring depositors. These programs are sometimes referred to as "friends and family" or loyalty programs. Although these arrangements may be formal and programmatic because they are both covered by a written agreement and the referring individual is paid a fee, FDIC might determine that the program is sufficiently limited in scope so that it is not deemed to be a brokered deposit arrangement. In this regard, FDIC considers whether the program is designed to significantly drive deposit growth to the IDI or is merely a small recognition of the customer's or employee's loyalty to the IDI.

In making the determination, FDIC considers whether the cost of the incentive package to the IDI is relatively small, the fee is de minimis to the recipient, and payments are capped in total amount or limited in frequency per individual.

Exceptions to the Definition of Deposit Broker

As mentioned above, there are exceptions to the definition of deposit broker; FDIC has applied the exceptions in a number of Advisory Opinions. FDIC does not treat any of the following parties as a deposit broker:

- An IDI, with respect to funds placed with that IDI;
- An employee of an IDI, with respect to funds placed with the employing IDI;
- A trust department of an IDI, if the trust or other fiduciary relationship in question has not been established for the primary purpose of placing funds with IDIs;
- A trustee of a pension or other employee benefit plan, with respect to funds of the plan;
- A person acting as a plan administrator or an investment advisor in connection with a pension plan or other employee benefit plan provided that person is performing managerial functions with respect to the plan;
- A trustee of a testamentary trust;
- The trustee of an irrevocable trust so long as the trust in question has not been established for the primary purpose of placing funds with IDIs;
- A trustee or custodian of a pension or profit-sharing plan qualified under section 401(d) or 403(a) of the Internal Revenue Code;
- An agent or nominee whose primary purpose is not the placement of funds with IDIs; or
- An IDI acting as an intermediary or agent of a U.S. government department or agency for a government sponsored minority or women-owned depository institution deposit program.

Q1: In regard to the exception for an "IDI, with respect to funds placed with that IDI," does the exception apply to a company affiliated with that IDI, including a parent or a subsidiary?

A1: No. The exception only applies to the IDI. However, an affiliate, including a parent or subsidiary, might not be a deposit broker for other reasons. Please see the full FAQs for further guidance.

Q2: In regard to the exception for an "employee of an IDI,

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with respect to funds placed with the employing IDI," does the exception apply to a contractor or a dual employee (*i.e.*, a person employed by an IDI and the IDI's parent or affiliate)?

A2: No. The statutory exception applies solely to an "employee" who satisfies the definition of an employee provided by the statute. The statute defines an "employee" as any employee: (1) who is employed exclusively by the IDI; (2) whose compensation is primarily in the form of a salary; (3) who does not share such employee's compensation with a deposit broker; and (4) whose office space or place of business is used exclusively for the benefit of the IDI which employs such individual. The exception will not apply to a contractor or dual employee because he/she will not be employed exclusively by the IDI as set forth in the statute. Even if the "employee" exception is not applicable, other reasons may exist for not considering a dual employee or contractor a deposit broker. Please see the full FAQ for further guidance.

Q3: A "dual-hatted" employee is a person employed exclusively by the IDI but who may be licensed to sell securities or other financial products. Are these employees considered to be deposit brokers?

A3: Generally no. Unlike dual employees, so call "dual-hatted" employees are employed exclusively by the IDI. These employees may open deposit accounts on behalf of the IDI and would not be considered deposit brokers solely because they are licensed to sell securities or other financial products to bank customers. Whether "dual-hatted" employees meet each of the other statutory elements of "employee" depends on the facts and circumstances of the situation.

Q4: Do situations exist when contractors and dual employees are not considered to be deposit brokers?

A4: Yes. FDIC does not believe that dual employees or contractors should be classified as deposit brokers in all situations. Although dual employees and contractors are not "employees" of the IDI under the statute because they are not "employed exclusively by the IDI," other exceptions may apply or they may not be considered to be engaged in the business of "placing deposits" or "facilitating the placement of deposits."

Consider a broker-dealer affiliate of an IDI where employees of the affiliate are also employees of the IDI. The fundamental role of some employees of the affiliate company may be to sell securities to clients, but they may also recommend deposit products. If a client wishes to invest in a deposit product, the dual employee refers the client to the IDI employee or may open the account personally. The broker-dealer affiliate is paid a fee, part of which is paid to the dual employee as a sales commission for opening the account and part of which is paid for the employee's continual interaction with the client in order to monitor balance activity, address client inquiries about rates, and provide information regarding additional accounts or account services, such as wire services. The ongoing fee is based on the balance of the account. In this case, the dual employee would be considered to have facilitated the placement of deposits, and the deposits would be brokered.

On the other hand, dual employees or contractors who merely perform "back-office" administrative work (and who are not involved in facilitating the placement of deposits) would not qualify as deposit brokers.

Q5: Are "call-center" personnel considered to be deposit brokers?

A5: Generally no. For purposes of these FAQs, "call-center" personnel primarily provide customer service support on behalf of the IDI by answering questions about accounts or bank-provided services or by transferring callers to appropriate areas of the IDI. Call center personnel may also answer questions about products and services provided to companies affiliated with the IDI. Call center personnel may be employed exclusively by the IDI, may be dual employees of the IDI and its affiliates, or may be contractors. Most often, call center personnel transfer, or "hand-off," a customer seeking to open a deposit account to an IDI employee, although call center personnel may sometimes be empowered to open accounts.

In cases where "call-center" personnel are exclusively employed by the IDI, the employee will likely fall under the statutory exception of "employee," and therefore would not be considered a deposit broker, even if they are empowered to open accounts on behalf of the IDI. Furthermore, call-center personnel who are dual employees or contractors would not be considered a deposit broker if: (a) they merely transfer callers or provide general information and do not participate in the placement of deposits; and (b) compensation is not based on the number of accounts opened or amount of deposits placed or maintained at an IDI as a result of call-center personnel's contact with the caller.

Even if "call-center" personnel are not deposit brokers, it would not necessarily mean that deposits will not be brokered. If another party, other than "call-center" personnel, is involved in the placement of the deposit, a separate analysis would be necessary to determine the status of the party.

Q6: What is the "primary purpose" exception to the definition of deposit broker?

A6: The exception applies to the following: an agent or nominee whose primary purpose is not the placement of funds with depository institutions. The exception is applicable when the intent of the third party, in placing deposits or facilitating the placements of deposits, is to promote some other goal (*i.e.*, other than the goal of placing deposits for others). The primary purpose exception is *not* applicable when the intent of the third party is to earn fees through the placement of the deposits. Also, the applicability of the primary purpose exception does not depend upon a comparison between the amount of revenue generated by the third party's deposit-placement activities and the amount of revenue generated by the third party's other activities. Rather, as previously stated, the applicability of the primary purpose exception depends upon the intent of the third party in placing deposits (or facilitating the placement of deposits).

There are several FAQs that address the primary purpose exception. FDIC considers each request to review and interpret the exception on a case-by-case basis. In interpreting the application of the primary purpose exception, FDIC frequently relies upon information provided by the requesting party, and other available information. As a result, changes in the program or in the facts as they had been provided by the requesting party may trigger a reassessment of the original determination.

Q7: Does the primary purpose exception apply to companies that sell or distribute general purpose prepaid cards?

A7: No. Some companies operate general purpose prepaid card programs, in which prepaid cards are sold to members of the public at retail stores or other venues. After the funds are collected from the cardholders, the funds may be placed by the card company or other third party into a custodial account at an IDI. The funds may be accessed by the cardholders through the use of their cards.

The selling or distributing of general purpose prepaid cards, accompanied by the placement of the cardholders' funds into a deposit account, is not secondary or incidental to the accomplishment of some other objective on the part of the prepaid card company. The general purpose prepaid card and the deposit account are inseparable, in that the card is a device that provides access to the funds in the underlying deposit account. Because of this relationship, prepaid card companies are not covered by the primary purpose exception. Therefore, prepaid card companies or other third parties, in selling or distributing prepaid cards, would qualify as deposit brokers, with the result that the deposits are classified as brokered deposits.

Q8: How does FDIC treat federal, state, or local agency (collectively, the Agencies) funds disbursed to beneficiaries of government programs through debit cards or prepaid cards?

A8: Agencies sometimes use debit or prepaid cards to deliver funds to the beneficiaries of government programs. In some cases, the program is structured so that each beneficiary will own a separate deposit account at a particular IDI (with the account being accessible by the beneficiary through the use of a debit card). Other programs may be structured so that multiple beneficiaries will own a commingled account with "per beneficiary" or "pass-through" deposit insurance coverage (with the commingled account being accessible by the beneficiaries through the use of prepaid cards). In these scenarios, though the deposits will not belong to the government but instead will belong to the beneficiaries, the Agencies might be involved in choosing the IDI or in opening the deposit accounts. Nevertheless, an Agency would not be considered a deposit broker if it meets one of the exceptions to the definition of deposit broker.

The exception that may be applicable in this circumstance is the primary purpose exception. FDIC would apply this exception when an Agency:

- Is mandated by law to disburse the funds to the beneficiaries;
- Is the sole source of funding for the deposit accounts; and
- Does not receive fees from the IDI, other than those fees necessary to help cover the Agency's administrative costs.

Satisfaction of these requirements would indicate that the primary purpose of the Agencies, in facilitating the placement of the beneficiaries' deposits, is not to provide the beneficiaries with a deposit-placement service or to assist the IDI in expanding its deposit base. Rather, satisfaction of the requirements would indicate that the primary purpose of the Agencies is simply to discharge the Agencies' legal obligations to the beneficiaries. Therefore, the Agencies would be covered by the primary purpose exception with the result that the deposits would *not* be classified as brokered deposits. When a request is received for a primary purpose exception from a government program, FDIC's interpretation applies to programs involving the: (1) Agency; (2) IDI; and (3) beneficiaries of the program. If another party is involved with operating the program, FDIC will need to make a separate determination as to whether that third party is a deposit broker.

Accepting Deposits

Q1: Can a brokered deposit that is not a time deposit (such as a demand deposit account), also known as a nonmaturity deposit, ever be reclassified as nonbrokered?

A1: Yes. Accounts holding brokered nonmaturity deposits, originally established with the involvement of a deposit broker, can be reclassified from brokered to nonbrokered after a 12-month period during which no third party (that is, no party other than the IDI and the depositor) is involved with the account. The 12-month period is considered appropriate since it is historically the most common term offered for a certificate of deposit (CD), and this treatment of nonmaturity deposits will create parity with the reclassification of most brokered CDs when they are renewed without involvement of a third party.

Involvement by a third party includes, for example: (1) holding the account in the name of the deposit broker as agent for one or more customers; (2) the deposit broker's continuing to receive account fees after the account is opened; (3) the deposit broker's having the authority to make withdrawals or additional deposits; or (4) the deposit broker's having continued access to the account. Continued access means that a third party will continue to receive access to the customer's account information that has been provided for the purpose of offering guidance to the customer as to the investment of the funds in the account.

It is also possible that involvement in a nonmaturity deposit by a third party could cease and then restart. As an example, if a deposit broker connects a customer to a particular IDI, and then there is a 12-month period of no involvement, the customer's account may be classified as nonbrokered. However, if after the 12-month period, the same broker or another third party becomes involved again with the account, then the account would again be reclassified as brokered. In addition, if during the 12-month period, the same broker or another third party becomes involved with the account, the account remains brokered until no third party is involved for a consecutive 12-month period.

Q2: If an IDI ceases to be well capitalized for Prompt Corrective Action (PCA) purposes, how should an IDI treat brokered deposits that are not time deposits (such as demand deposits)?

A2: If an IDI ceases to be well capitalized for PCA purposes, the brokered deposit restrictions of Section 29 of the FDI Act will apply. Therefore, the IDI should contact its primary federal regulator to establish an appropriate supervisory plan for addressing how brokered demand deposit accounts can comply with Section 29. In determining a supervisory plan, the IDI's primary federal regulator and FDIC will consider how brokered deposits could impact the IDI's liquidity, bank operations, or other factors. The goal of any supervisory plan regarding brokered deposits would be to not disrupt an IDI's operations as it attempts to improve its capital category.

If the IDI is adequately capitalized for PCA purposes, the IDI may request a waiver from FDIC to retain or accept brokered deposits. Even when the IDI is undercapitalized for PCA purposes, FDIC deals with each brokered deposit situation involving accounts that are not time deposits on a case-by-case basis.

Resources

FDIC Law, Regulations and Related Acts: www.fdic.gov/regulations/laws/rules/index.html

See "Brokerage Activities": www.fdic.gov/regulations/laws/rules/4000-100.html#brok ■

Judicial Spotlight

Wisconsin Supreme Court Clarifies that Builder's Risk Policy Benefiting Construction Lender Does Not Terminate When Homeowners's Policy is Put in Place

Notice 2016-12

The Wisconsin Supreme Court declared in a recent case that a homeowner's policy on property under construction put in place prior to the house being completed and sold was not "permanent property insurance" under the builder's risk policy protecting the developer and the construction lender. The Court's decision means that the existence of the homeowner's policy during the construction period did not end coverage under the builder's risk policy. This is a good result for Wisconsin banks. The case is *Fontana Builders, Inc. et al. v. Assurance Company of America*, (2016 WI 52).

The Facts in the Case

AnchorBank made construction loans to Fontana Builders, Inc. to build a house, secured by mortgages on the property. James Accola was the president and sole owner of Fontana, and also the prospective buyer of the house under construction. As would typically be required by the construction lender, Fontana procured from Assurance Co. of America typical builder's risk insurance on the house under construction and the bank was listed as loss payee on the insurance policy. Accola arranged for a separate loan from Anchor to purchase the house from Fontana after construction, and in fact moved in before construction was complete. Anchor required Accola to procure a homeowner's policy as a condition to funding the home purchase loan. Accola arranged for homeowner's insurance from Chubb in his and his wife's name before construction was complete and before ownership of the house transferred to them.

Shortly after the Accolas moved in but before they owned the house, there was a fire and the house was damaged. Accola sought coverage under his personal homeowner's policy. Chubb and Accola, without the bank's involvement, entered into a confidential settlement agreement under which they settled for a significant sum Accola's claims for damages caused by the fire, including loss to personal property, and for temporary living expenses. Despite that payout, some of which went to Anchor, the majority of Anchor's loans remained unpaid. Fontana subsequently brought a suit against Assurance to recover its damages under the builder's risk policy, and Anchor intervened.

The only provision of the builder's risk policy at issue was a typical termination provision which states that coverage ends "[w]hen permanent property insurance applies." The question before the Wisconsin courts was whether the homeowner's policy in this case constituted "permanent property insurance" that "applies" such that the builder's risk policy terminated when the homeowner's policy was put in place.

In the first trial, the trial court granted summary judgment to Fontana, holding that the builder's risk policy applied as a matter of law. This meant that the presence of a homeowner's policy prior to the end of construction and transfer of the property to the homeowner did

Wisconsin Bankers ASSOCIATION

Compliance Journal

Special Focus

CFPB Payday Loan Proposal Will Impact Depository Institutions

Notice 2016-12

In June 2016, the Consumer Financial Protection Bureau ("CFPB") released its long-awaited proposed rules—all 1,334 pages of them—to regulate payday lenders, automobile title lenders and other lenders of small dollar installment credit (the "Proposed Rules").

While the bulk of the criticisms and commentary on the Proposed Rules have come from companies that are in the payday lending and auto title loan business, and that have essentially said that the Proposed Rules would put them out of business, much less attention has been paid to the adverse implications the Proposed Rules would present for depository institutions, particularly smaller insured depository institutions that still routinely offer and make small consumer loans to their customers and members.

This article focuses on how depository institution lenders would be affected by the Proposed Rules if they are enacted, and advocates for a complete exemption for insured depository institutions from these anti-predatory lending regulations.

Insured depository institutions that have long offered and made small consumer installment loans were never historically a problem from a predatory lending perspective, and these institutions should not now be painted with the CFPB's same "payday lending" brush with which they are addressing nondepository lenders.

Prior to discussing the CFPB's proposal to "federalize" small-dollar consumer lending, it is worth reviewing what the state legislatures have been doing to regulate this area during the past decade. Over 35 states have now passed their own rules and regulations that apply to payday lending and title lending. Like the case in Wisconsin, many state laws require licensing and examination of these lenders by state agencies; it is also true that almost all state laws that have been passed, including Wisconsin's, have included broad exemptions from coverage for insured depository institutions.

Notwithstanding the considerable recent state legislative activity to control perceived abuses in this kind of lending, including the establishment of comprehensive licensing requirements, the CFPB apparently is ready to run roughshod over state efforts and instead impose breathtakingly complex new federal requirements for all types of lenders who make "covered loans," including insured depository institutions.

Covered Loans

The CFPB's proposed rules address three different types of loans, and the requirements under the rules differ based on the loan type:

(a) **Covered Short-Term Loans**

Typically these are closed-end, single advance loans where the entire amount is due within 45 days of consummation.

Consider the following: A customer of your institution is currently in some financial distress and desperately needs to borrow $1,000 from your institution to pay for some immediate health care and car repair expenses. She would like to borrow from a bank, not an Internet payday lender. Your institution agrees to make the loan and the customer agrees to repay the loan in full in 45 days out of her next three paychecks.

This example would constitute a "Covered Short-Term Loan" under the CFPB's proposed rules, and the related requirements for this type of credit are described below.

(b) **Covered Longer-Term Loans**

Typically, these will be closed-end, single advance loans where the entire amount of the loan is not repayable within 45 days and in which:

• the "total cost of credit" exceeds 36% per annum; and

• the lender obtains a security interest in a motor vehicle; or

• the lender obtains a "leveraged payment mechanism" to repay the loan.

(c) **Covered Longer-Term Balloon Payment Loans**

These are "covered longer-term loans" requiring repayment in a single payment, or where at least one payment is more than twice as large as any other payment.

(d) **Excluded Loans**

The CFPB's proposal excludes any real estate secured loans, credit cards, student loans and most "purchase money" security loans.

What Are the New Loan Rules?

Certainly one of the most controversial of the Proposed Rules is the requirement for the lender to complete an "ability to repay" analysis not dissimilar to the process done today to determine if a real estate loan is a "qualified mortgage." It is this requirement that many in the industry have said will lengthen and make the loan application process more expensive, and will cause many financial institutions to exit the "small-loan" business, which today is done most often as a customer accommodation.

Under the Proposed Rules, a lender cannot make a "covered short-term loan" without first making a "reasonable determination that the consumer will have the ability to repay the loan according to its terms." To make this ability to repay determination, a lender must reasonably conclude that:

• the consumer's residual income is sufficient to make loan payments and to meet living expenses during the loan term; and

• the consumer will be able to pay for any "major financial obligation" when due, make all payments on the loan and meet basic living expenses for 30 days after the highest loan payment.

Lenders will be required to obtain "verification evidence" of the consumer's claimed income and expenses, which may include receiving a written statement from the consumer about income and expenses. Paystubs or deposit records also should satisfy this verification requirement. Record keeping requirements would apply, too.

Requirement to Give Payment Notice

One of the more cumbersome and costly provisions of the Proposed Rules is the requirement for lenders to deliver a notice to consumers in advance of each payment coming from a "leveraged payment mechanism" involving the consumer's account. If the notice is given electronically, it must be provided no earlier than seven and no later than three business days before the payment transfer—or no earlier than ten nor later than six days if the notice is mailed.

Electronic Delivery of Disclosures

The Proposed Rules would permit all notices and disclosures to be sent electronically provided the customer consents. Customers also may revoke consent for any reason, meaning, in some cases, lenders will be required to mail all disclosures.

Conclusion

There are obviously many details in the Proposed Rules that cannot reasonably be addressed in this brief summary.

It is critical, however, that community banks, savings and loans, and other insured depository institutions all recognize the scope of this proposal, and should be alarmed about this proposed federal regulatory takeover of their small consumer loan programs. WBA will be filing comments with the CFPB before the comment period ends on **October 7, 2016**, and will make available a model comment letter for its members to customize and file in advance of the deadline.

WBA would like to thank Atty. James A. Sheriff with Reinhart Boerner Van Deuren s.c. for providing this article. ■

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Wisconsin Bankers ASSOCIATION

Compliance Journal

Special Focus

Complying with Change in Bank Control Rules

Notice 2016-13

In a world of ever-increasing and changing bank regulation and compliance burden, there is yet another regulatory initiative underway. The Federal Reserve is increasing its focus on the "Change in Bank Control" rules. These rules have been around a very long time, but historically were not heavily monitored by the Federal Reserve. This is no longer the case. Although the language of the Change in Control statutes and regulations has not changed, the requirements for compliance are currently in flux, and are growing. Many of the specific compliance requirements are not written down in any statute, regulation or interpretive guidance issued by the Federal Reserve.

Technically, it is shareholders who must comply with the Change in Control rules, not banks and their holding companies. However, the Federal Reserve will provide holding companies with notifications about shareholder violations of the Change in Control Act, and generally appears to expect holding companies to work with their shareholders to become compliant. In addition, holding company and bank management and directors often are members of family groups that are subject to (and often inadvertently violate) the Change in Control rules.

What triggers an obligation to file a Change in Control application with the Federal Reserve?

Under the Change in Control rules, prior approval from the Federal Reserve is generally required before any one person or group of persons "*acting in concert*" acquires "*control*" of a bank holding company. There are a few exceptions, discussed below, when shareholders can instead notify the Federal Reserve after the Change in Control has occurred.

Under the regulations, it is presumed that a shareholder and his or her "immediate family" are "acting in concert". This means the Federal Reserve presumes that immediate family members coordinate and cooperate on how they vote their shares, and vote together as a group. "Immediate family" includes all of the following:

a shareholder and his or her father, mother, stepfather, stepmother, brother, sister, stepbrother, stepsister, son, daughter, stepson, stepdaughter, grandparent, grandson, granddaughter, father-in-law, mother-in-law, brother-in-law, sister-in-law, daughter-in-law, the spouse of any of the foregoing, and the person's spouse.

Included in the list of family members "acting in concert" is any entity or trust which holds shares if the voting of those shares is controlled by any of these family members. Consequently, to determine the number of shares a family group controls, you need to include all shares a family member holds in his or her revocable trust or IRA, for example, if the family member controls how those shares are voted. You will also need to include the shares held by a company if a family member either i) controls how those shares are voted or ii) is a controlling shareholder, partner or management official of the company and also separately holds shares in his or her individual capacity.

Although the Federal Reserve presumes that immediate family members vote their holding company shares in a concerted way, the regulations say that the presumption is "rebuttable". The regulations provide a process for rebutting the presumption. A family group is allowed to present views to the Federal Reserve in writing or orally stating why the group should not be presumed to vote the shares in a coordinated way. Unfortunately, we have been told that the Federal Reserve has never agreed with arguments trying to rebut the presumption. We recommend that families do not waste time trying to argue that they are not "acting in concert".

There are various scenarios that trigger a Change in Control filing:

- If the upcoming acquisition of shares by any member of an "immediate family" as defined above will take the total family ownership above 10% of the outstanding shares of the holding company, and no other person owns, controls or holds the power to vote a greater percentage of the outstanding shares, a filing for prior approval is required.
- If the upcoming acquisition of shares by one person will take that one

person over 10% ownership, and no other person owns, controls or holds the power to vote a greater percentage of the outstanding shares, a filing for prior approval is required. The Federal Reserve notes that if two or more persons, not acting in concert, each propose to acquire simultaneously equal percentages of 10% or more of a class of voting securities, and no other shareholder owns more than that percentage, each person must file for approval.

- If the upcoming acquisition of shares by one person or a group acting in concert will take the person or the group over 25% ownership, regardless of what anyone else owns, controls or holds, a filing for prior approval is required.

- Even if a family group has been approved as a "control group", if another family member is added to the group (such as a transfer of shares to a new grandchild, which happens often), a new filing is required. Similarly, if a member of the family control group decides to put shares in a revocable trust as part of estate planning (also common), because the trust is a separate legal entity, it is considered a new member of the group and a new filing is required.

Any current member of an approved family control group can acquire more shares without triggering a new filing, unless those shares will take that person individually over 10% (and no other shareholder owns or controls more than that person), or over 25% (regardless of what other shareholders own or control). If the acquisition takes the person over these thresholds, a new filing will be required even if the family group is already approved.

Certain stock acquisitions which result in one of the Change in Control transactions described in the bullets above will require an *after the fact* notice to the Federal Reserve, which must be filed within 90 days of the transaction:

- Acquisition of voting securities through inheritance.

- Acquisition of voting securities through a bona fide gift.

- Acquisition of voting securities in satisfaction of a debt previously contracted in good faith.

The filing requirements are virtually the same for these after the fact notices. The only meaningful difference is the timing.

A very common filing in the past few years is known as a "clean-up" filing. A "clean-up" filing is not explicitly addressed in the statutes or regulations. It is essentially a mechanism created by the Federal Reserve to "fix" a violation of the Change in Control rules. A clean-up filing is an after the fact Change in Control application (filed once the violation is discovered) requesting that the Federal Reserve grant approval for a shareholder or family group to "retain" its controlling interest in shares. Clean-up filings are common because shareholders typically have no idea these rules exist and often inadvertently violate them. A clean-up filing will be required even when the family has held a controlling interest since the formation of the bank or holding company, if *any* changes have occurred in the family control group since that time (often the addition of new family members through gifts or inheritance, or of trusts through estate planning).

In the clean-up application, the family group should explicitly acknowledge that they know they are in violation of the Change in Control rules, and state that the violation was inadvertent and not intentional. The family group should also commit to make all family members aware of the Change in Control requirements, and to follow the requirements in the future. To date, we are not aware of any adverse action taken by the Federal Reserve against a family group in connection with a "clean up" filing.

If a filing is required, what are the steps to seek approval?

The Change in Control approval process is lengthy, and requires the compilation and filing of a

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large amount of information. What the Federal Reserve requires now is much more detailed and complex than in years past. Here are the components of a Change in Control filing:

- *Interagency Notice of Change in Bank Control*: filed with the Federal Reserve, and contains information about the holding company, the terms of the stock acquisition, the resultant ownership of shares by the shareholder or the control group, and very basic biographical information about the shareholder or control group.
- *Interagency Biographical and Financial Report (IBFR)*: filed with the Federal Reserve, and contains extremely detailed information about larger shareholders' biographical and employment history and current financial holdings (including real estate, investments, debt). Note that shareholders should explicitly request in the filing, and will receive, confidential treatment for this very personal non-public information. The Federal Reserve will require an IBFR from larger shareholders, whether they hold the shares individually or through a trust, IRA or other mechanism. Shareholders should consult with the Federal Reserve in advance to discuss the holdings of the shareholders within the group and get direction about which shareholders need to file the biographical and financial information.
- *Public notice* of the request to become a controlling shareholder or family group, or to retain a controlling ownership (in the case of a clean-up filing), which is published in the newspaper in the community where the holding company's main office is located. This notice names the shareholder and members of the family group, and where they live (by city and state).

The Federal Reserve will review the filing and invariably request additional information. For certain larger shareholders, they will require fingerprint cards and run background checks. In one recent filing, a bank president's very elderly mother was required to go to the police station to be fingerprinted, despite protest.

Once the Federal Reserve is satisfied with the information provided, and after the 30 day public comment period has expired, the Federal Reserve will provide an approval letter (assuming it is comfortable allowing the shareholder or family group to gain or retain a controlling interest in the holding company). To date, we have not seen the Federal Reserve deny a Change in Control request by any shareholder or family group.

Holding companies may run into problems if shareholders do not want to cooperate. The information requested is very personal, and shareholders often do not want to turn over this information to the government. Some shareholders have gotten very angry in this process, and others have simply refused to cooperate with family members who are trying to file the family's Change in Control application. The Federal Reserve has taken the position that it has the right to this information under the Change in Control laws, and therefore presumably has the right to sanction non-cooperative shareholders. We have not yet seen the Federal Reserve take any adverse action against a non-cooperating shareholder (although there are cases ongoing that have not yet been resolved). As more and more Change in Control violations by families are identified by the Federal Reserve, we may see more instances of non-compliance by shareholders. This may eventually trigger Federal Reserve action.

Are there any other components of the Change in Control process that are proving difficult with the Federal Reserve?

Trusts. When members of a current or prospective family control group own shares through their estate planning trusts, or if a trust is seeking to hold or holds a controlling interest in a bank holding company, shareholders and bankers should be aware that trusts have become the subject of intense scrutiny during the Change in Control review process. As discussed below, review of larger trust shareholders may also emerge as a component of Federal Reserve merger and acquisition applications at some point in the near future.

In connection with Change in Control filings, the Federal Reserve is now requiring any trust that is part of a family control group which holds at least 2% of the outstanding stock of the holding company to file copies of its trust documents and all amendments. The trust also needs to provide, with specificity, a list of current assets in the trust and the current value of each of those assets. Often, the Federal Reserve will ask for the size of the trust's holdings of securities of other businesses (for example, "the trust owns 3.5% of the outstanding shares of ABC, Inc.")

There are specific things that the Federal Reserve evaluates when looking at trust or prospective trust shareholders. They want to know who controls the voting of bank holding company shares held by a trust. Sometimes it is not entirely clear who votes the shares. If there are two trustees, does the trust allow either to vote? If so, who actually does the voting? Is the consent of both trustees required to vote? Sometimes an independent trustee votes the shares, which means that trustee will be subject to scrutiny if the trust holds a sufficiently large number of shares. This can raise concerns if the independent trustee is, for example, another bank.

The Federal Reserve will also evaluate whether the trust is itself a bank holding company that is subject to registration and all of the other rules governing bank holding companies. The first question they ask is whether the trust is a "company" under the Bank Holding Company Act and Federal Reserve regulations. Here are the operative guidelines about when a trust is a "company":

- A business trust is a company. "Business trust" is not defined, and is discussed in more detail below.
- Any other trust is a company, unless by its terms it terminates either within 25 years, or within 21 years and 10 months after the death of individuals living on the effective date of the trust (commonly known as the "rule against perpetuities" language).
- Unless the Federal Reserve determines that a trust is being operated as a business trust or company, a trust is presumed not to be a company if the trust:
  - Terminates within 21 years and 10 months after the death of grantors or beneficiaries of the trust living on the effective date of the trust or within 25 years;
  - Is a testamentary or inter vivos trust established by an individual or individuals for the benefit of natural persons (or trusts for the benefit of natural persons) who are related by blood, marriage or adoption;
  - Contains only assets previously owned by the individual or individuals who established the trust;
  - Is not a Massachusetts business trust; and
  - Does not issue shares, certificates, or any other evidence of ownership.

If a shareholder holds a significant number of shares of a bank holding company, the very safest approach to estate planning from the perspective of avoiding becoming a bank holding company is to structure the trust to qualify for the presumption described above.

One way the Federal Reserve evaluates the activities of the trust to determine if the trust is more than just a passive estate planning vehicle (and therefore may be a "business trust") is to review the value and nature of the assets in the trust. This is the reason they ask for lists of trust assets. There is an unwritten but important rule that the trust can have no more than 25% of what the Federal Reserve calls "impermissible assets" and 75% of what it calls "permissible assets." The Federal Reserve has not defined "impermissible" and "permissible" assets, and will not provide a definitive list of what are impermissible and permissible. Generally, the Federal Reserve appears to consider assets related to nonbanking activities that are prohibited to banks and their holding companies to be "impermissible" (such as holding the shareholder's primary residence or vacation home, or a controlling interest in a privately held small business), and assets related to exempt or permissible nonbanking activities that are permitted for banks and their holding companies to be "permissible" (such as permissible investment securities). The stock of a bank holding company is considered a "permissible asset."

If the value of the impermissible assets exceeds 25%, the Federal Reserve will direct the trust to take steps to either alter the balance of the assets or, more commonly, to set up a "mirror trust" (*i.e.* an identical trust) and move the bank holding company stock to the mirror trust so it is the only asset in that trust. We do not know exactly what the Federal Reserve would do if a trust were to refuse to take steps to correct the balance of assets in the trust, as we have never had a trust shareholder refuse to cooperate.

What should bankers do now?

Bankers should evaluate their current holding company shareholder lists, and try to identify large shareholder family control groups. They should reach out to representatives of a family control group to determine whether one or more Change in Control filings should have been made, but were not. They should also let those family representatives know about the requirements for new filings if the composition of the family control group changes (such as by transferring shares to new members, or putting shares into a trust), and can direct shareholders to get legal assistance from a banking attorney when structuring an estate planning trust. These steps can help avoid inadvertent violations.

These violations and the requirement to do a clean-up filing are generally coming up these days in the context of Federal Reserve applications for a merger or an acquisition of another bank or holding company. The Federal Reserve evaluates the ownership of the holding company. It tries to determine if the proposed transaction itself will trigger a Change in Control, ***and also*** whether historic Change in Control violations have taken place in the past. So far, the Federal Reserve has allowed transactions to proceed even if there has been a violation, but requires a clean-up filing promptly after the transaction has closed. Holding companies will often connect representatives of the shareholder family group with banking counsel to assist with this complicated and frustrating process.

Why this regulatory focus?

This is a question bankers and shareholders often ask. We have not yet received meaningful answers. We have been told that this focus on Change in Control and trusts has come down from the Federal Reserve Board in Washington, but that is all we know. At this point, we can only speculate about the reasons.

WBA wishes to thank Atty. Kristen Spira, Boardman & Clark, llp. for this article. ■

Regulatory Spotlight

Agencies Issue Notice on Proposed Call Report Changes.

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies), as members of the Federal Financial Institutions Examination Council (FFIEC), have issued a notice for public comment of a proposal for a new Consolidated Reports of Condition and Income for Eligible Small Institutions (FFIEC 051). The Consolidated Reports of Condition and Income are commonly referred to as the Call Report. The proposed FFIEC 051 is a streamlined version of the existing Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only (FFIEC 041), which has been created by removing certain existing schedules and data items that would be replaced by a limited number of data items that would be collected in a new supplemental schedule, eliminating certain other existing data items, and reducing the reporting frequency of certain data items. FFIEC 051 generally would be applicable to institutions with domestic offices only and assets of less than $1 billion. FFIEC 041 would be applicable to institutions with domestic offices only that do not file the FFIEC 051. When compared to the existing FFIEC 041, the proposed FFIEC 051 shows a reduction in the number of pages from 85 to 61. The decrease is the result of the removal of approximately 950 or about 40 percent of the nearly 2,400 data items in the FFIEC 041. In addition, FFIEC and the agencies are seeking public comment on proposed revisions to the FFIEC 041 and the Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices (FFIEC 031), which are currently approved collections of information. The proposed FFIEC 051 and the revisions to the FFIEC 041 and FFIEC 031 would take effect as of the **03/31/2017**, report date. Comments are due **10/14/2016**. The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-08-15/pdf/2016-19268.pdf. *Federal Register*, Vol. 81, No. 157, 08/15/2016, 54190-54216.

Agencies Seek Comment on OMB Review of Regulatory Capital Property.

The Office of the Comptroller of the Currency (OCC), the Department of the Treasury (Treasury);
Board of Governors of the Federal Reserve System (FRB), and Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies) request comment on a submission of a request to OMB for review and approval of revisions to supplementary leverage ratio data in new Supplementary Leverage Ratio tables 1 and 2 of the Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework Schedule A. Comments are due **09/19/2016**. The notice may be viewed at: https://www.gpo.gov/fdsys/pkg/FR-2016-08-18/pdf/2016-19721.pdf. *Federal Register*, Vol. 81, No. 160, 08/18/2016, 55260-55263.

Agencies Issue Correction on Reporting Threshold.

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC) have issued a correction to a notice that appeared in the *Federal Register*, appearing on pages 54190 through 54216 in the issue of **08/15/2016**. The corrections are as follows: (1) On page 54213, at the top of the page, above the table labelled Data Items Removed, insert the heading "Appendix B" and, on the following line, insert the heading "FFIEC 031: Data Items Removed or Change in Reporting Threshold"; (2) On page 54214, above the table labelled Data Items Removed, insert the heading "Appendix C" and, on the following line, insert the heading "FFIEC

Wisconsin Bankers ASSOCIATION
Compliance Journal
Special Focus

The TCPA Threat: Practical Compliance Considerations for the Modern-day Banker

Notice 2016-14

Communication is vital in any relationship, including an institution's relationship with its customer. Modern technology provides institutions with useful tools to facilitate these communications, including, for example, text messaging, email, social media, and autodialed calls. While it is important for institutions to capitalize on the multiple channels available to communicate with existing and potential customers, it's equally as important to understand the regulatory framework under which these communications are governed.

Enter the Telephone Consumer Protection Act (TCPA). The TCPA, which became law in 1991, was originally established to address unsolicited calls to landlines and then-modern cell phones. Twenty five years after its inception, the TCPA – prescribed primarily in implementing regulations, guidance and orders issued by the Federal Communications Commission – has taken on a new life in an attempt to govern current technology. Recent changes to TCPA law (issued in 2013 and 2015) have generated renewed attention and growing concern surrounding effective but compliant communications with customers. Rightfully so, as penalties for non-compliance – ranging from $500 to $1,500 per violation (per call) – can truly break the bank. Given the repercussions of non-compliance, it is critical for all bankers to understand the TCPA and how the law interacts with the institution's business practices. At that point, the institution will be in a position to determine whether to communicate with customers using channels that avoid the TCPA or to submit to TCPA compliance.

If your institution uses or is considering using one of the following mechanisms to communicate with customers, these communications will be governed by the Telephone Consumer Protection Act (TCPA):

- Text messages
- Calls to landlines or cell phones using an autodialer
- Calls to landlines or cell phones using a pre-recorded or artificial voice

Prior to communicating with consumers using one of these channels, the institution must obtain the consumer's consent. Dependent upon the nature of the communication, one of two types of consent is required – (1) prior express consent or (2) prior express <u>written</u> consent. If the contact <u>does not</u> include a telemarketing/advertising message, an institution must obtain prior express consent from the consumer. Contacts of this nature would include, for example, debt collection, checking account notifications (e.g. insufficient funds alerts), or informational contacts with potential customers. In contrast, if the contact includes telemarketing or advertising content, a consumer's prior express <u>written</u> consent will be required.

Obtaining a consumer's prior express (non-written) consent is a relatively simple process. Interpretative Orders issued by the FCC have stated that obtaining a cell phone number from a consumer is sufficient to provide such consent. Thus, assuming the institution has obtained a cell phone number from a customer in the course of the banking relationship (e.g. in the Account Signature Card), the institution has the ability to contact that customer for non-telemarketing/advertising purposes using the above-described mechanisms. No additional disclosures are required to be provided by the institution and, furthermore, no contractual agreement between the institution and consumer is required by law. Put simply, documents should not need to be modified.

In contrast, if an institution wishes to contact a consumer using an above-listed mechanism for telemarketing/advertising purposes, prior express <u>written</u> consent must be obtained. This level of consent requires all of the following:

- Written agreement
- Signature of person called
- The following "clear and conspicuous" disclosure:

- "By executing this agreement, such person authorizes the seller to deliver or cause to be delivered to the signatory telemarketing calls using an automatic telephone dialing system or an artificial or pre-recorded voice; and
- The person is not required to sign the agreement (directly or indirectly), or agree to enter into such an agreement as a condition of purchasing any property, goods, or services."

- Telephone number authorized to receive such messages

The TCPA does not prescribe how to capture a consumer's written consent. As a best practice, however, an institution should consider using a standalone agreement to obtain this consent in light of both legal and practical considerations. To that end, it is prudent for an institution to work with legal counsel to tailor the consent agreement to the institution's particular circumstances and to, furthermore, delineate proper use.

In addition to obtaining consent, there are a number of additional considerations for an institution when determining whether and how to communicate with consumers under TCPA, regardless of the nature of the contact. First, consumers have the opportunity to opt-out of receiving any communications at "any time" using "any reasonable means". This requires the institution to have systems in place to quickly manage a customer's opt-out request regardless of how and to whom the opt-out request originated. In turn, these systems must be capable of tracking which institution customers have consented and the type of consent (written or non-written) given, as applicable. Practically speaking, an institution will not have 100% consent from all customers and systems must be capable of managing to that reality. Furthermore, these systems must "talk" to those who are responsible for originating calls; otherwise, violating TCPA and incurring a steep fine is just a matter of time.

Finally, there are several notable exemptions from TCPA. Relevant to bankers, contacts that alert customers to a data security breach or identity theft or notifications of suspected or actual fraudulent activity on a customer's account are exempt. Additionally, contacts related to a customer's money transfer are also exempt. In order to take advantage of these exemptions, however, an institution must adhere to certain requirements including, for example, a limitation on the number of customer contacts, content requirements, and formatting requirements for text messages. In the non-telemarketing context, complying with exemption requirements may, in fact, be more onerous than obtaining a phone number to meet prior express consent requirements under TCPA.

As your institution continues to innovate by identifying creative ways to connect with new or existing customers, it's critical to consider the TCPA. Understanding the law, along with the practical impacts, should help guide business decisions and will certainly facilitate compliance.

**This article does not address other laws that may apply to an institution's communications with customers such as "do not call" registry requirements and the Fair Debt Collection Practices Act, as applicable.*

WBA wishes to thank Atty. Lauren C. Capitini, Boardman & Clark, llp. for this article. ■

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Wisconsin Bankers Association
Compliance Journal
Special Focus

HMDA: Bankers Should Use 2017 to Prepare for Large-Scale Changes

Notice 2016-15

In October 2015, the Consumer Financial Protection Bureau (CFPB) issued the long-anticipated Final Rule amending the Home Mortgage Disclosure Act's (HMDA) implementing regulation – Regulation C. The Rule, which takes effect in multiple stages beginning in January 2017, has vast impacts ranging from coverage under the Rule to data submission. Bankers should take note of the impactful changes and timeline for implementation. First and foremost, a bank should determine whether it is a reportable financial institution under the new coverage test which takes effect in January 2017, and if so, use the 2017 year to prepare for large-scale changes to data collection requirements which take effect in January 2018.

The 2015 HMDA Rule changes primarily affect the following areas, which are summarized below[1]:

- Institutions subject to Regulation C
- Transactions subject to Regulation C
- Data collection and reporting requirements
- Process for reporting and disclosing data
- Posted Notices

[1]This article addresses HMDA changes for banks only. Furthermore, this article presents a summary of the Rule. Readers should review the Rule in its entirety.

<u>*Institutions subject to Regulation C*</u>

The 2015 HMDA Rule, first and foremost, modifies those financial institutions subject to HMDA reporting requirements. Overall, the revisions, which will take effect in two phases beginning in January 2017, attempt to limit the number of financial institutions subject to the Rule by adding new criteria that must be met before a bank becomes HMDA-reportable.

By way of background, existing Regulation C requires a bank meet the following criteria in order to be subject to HMDA requirements:

(1) ***Asset-Size Test***. As of the preceding December 31, had assets in excess of $44 million[2];

(2) ***Location Test***. As of the preceding December 31, had a home or branch office in an Metropolitan Statistical Area (MSA);

(3) ***Loan Activity Test***. In the preceding calendar year, originated at least one home purchase loan (excluding temporary financing such as a construction loan) or a refinancing thereof, secured by a first lien on a one-to-four family dwelling; and

(4) ***Federally Related Test***. Meet one of the following criteria:

a. The Bank is Federally insured or regulated; or

b. The mortgage loan (described in (3)) was insured, guaranteed, or supplemented by a Federal agency; or

c. The mortgage loan (described in (3)) was intended for sale to Fannie Mae or Freddie Mac

[2]This asset threshold is set each year by the CFPB.

The new HMDA Rule adds a 5th criterion, called the "Loan Volume" test, to the unchanged criteria, as described above. The addition of the Loan Volume test, which is being implemented in two phases, serves to narrow the scope of banks covered by the regulation. The first phase, which becomes effective in January 2017, adds the following criterion to those listed above:

(5) In each of the two preceding calendar years, originated at least 25 covered home purchase loans, including refinancings of home purchase loans

Thus, if a bank previously met the financial institution coverage test but does not meet this additional criteria based on 2015 and 2016 loan data, the bank will no longer be subject to HMDA requirements beginning in January 2017.

The second phase, which becomes effective in January 2018, modifies the Loan Volume test, as follows:

(5) Meets at least one of the following criteria:

A. In each of the two preceding calendar years, originated at least 25 covered closed-end mortgages; or

B. In each of the two preceding calendar years, originated at least 100 covered open-end lines of credit

Thus, if a bank previously met the financial institution coverage test but does not meet this additional criteria based on 2016 and 2017 loan data, the bank will no longer be subject to HMDA requirements beginning in January 2018.

The addition of these criteria will only serve to narrow the list of HMDA-reportable financial institutions. Therefore, a bank should determine if the addition of this 5th criterion will impact the institution's coverage under HMDA in 2017. Furthermore, even if the bank is required to report 2017 HMDA data, it should determine, assuming it's close to new loan volume thresholds, whether or not it should limit its transactions in 2017 and beyond in order to avoid HMDA compliance in the future. Additionally, for those banks who will no longer be subject to HMDA requirements, along with those originating loans near new loan volume thresholds, it would be prudent to monitor loan volume on an ongoing basis. Monitoring loan volume for these purposes will help facilitate ongoing compliance with HMDA, as loan volume thresholds can easily be surpassed without proper tracking.

Transactions subject to Regulation C

Additionally, the new HMDA Rule modifies the types of covered transactions. Beginning on January 1, 2018 for data collected on that date or later, the following types of loans, absent an exclusion, are subject to HMDA coverage:

- Consumer-purpose, closed-end loans and open-end lines of credit secured by a dwelling; and
- Business-purpose, closed-end loans and open-end lines of credit secured by a dwelling that are home purchase loans, home improvement loans, or refinancings ONLY.

To elucidate, a Dwelling is defined broadly under the HMDA Rule as a residential structure. Examples of dwellings and non-dwellings are as follows:

Dwellings

- Principle residence
- Second homes and vacation homes
- Investment properties
- Residential structures attached to real property
- Detached residential structures
- Individual condominium and cooperative units
- Manufactured homes or other factory-built homes
- Multifamily residential structures or communities. For example, apartment buildings, condominium complexes, cooperative buildings or complexes, and manufactured home communities
- Structures used for both residential and commercial purposes if the primary use is residential

Not Dwellings

- Recreational Vehicles (RVs), such as a boat, camper, travel trailer
- Houseboats or floating homes
- Mobile homes constructed before June 15, 1976
- Transitory residences, such as hotels, hospitals, college dorms, or RV parks
- Structures originally designed as a dwelling but used exclusively for commercial purposes (e.g. conversion of a home to an office).

When assessing whether a transaction is a covered transaction under the HMDA rules, banks should first determine if a loan meets these criteria described above. If so, the bank should next assess whether the loan is excluded under the Rule.

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The 2015 HMDA Rule retains existing exclusions and also expands the types of excluded transactions. Beginning in 2018, the following loans are excluded from coverage:

- Closed-end Mortgage Loans or Open-End Lines of Credit ("Covered Transactions")[3] originated or purchased in a fiduciary capacity (e.g. as a trustee);
- Covered Transactions secured by a lien on vacant or unimproved land (except if the bank is aware that loan proceeds will be used within two years of closing/account opening to construct or purchase a dwelling to be placed on the land);
- A Covered Transaction that is temporary financing – that is, a loan designed to be replaced with permanent financing at a later time;
- The purchase of an interest in a pool of Covered Transactions (such as mortgage-backed securities);
- The purchase solely of the right to service Covered Transactions;
- The purchase of Covered Transactions via a merger or acquisition or acquisition of all of a Branch Office's assets and liabilities;
- Covered Transactions or applications for Covered Transactions in a total dollar amount less than $500;
- The purchase of a partial interest in a Covered Transaction;
- Covered Transactions if the proceeds are used primarily for agricultural purposes;
- Covered Transactions in which the secured dwelling is located on property that is used primarily for agricultural purposes;
- Covered Transactions that are or will be made primarily for business or commercial purposes, unless it is a Home Improvement Loan, a Home Purchase Loan, or a Refinancing;
- A Closed-End mortgage loan if the bank originated fewer than 25 Closed-end mortgages in each of the two preceding calendar years; and
- An Open-End Line of Credit if the bank originated fewer than 100 Open-End Lines of Credit in each of the two preceding calendar years

Bankers should note that although not listed as an exclusion, if a transaction modifies, renews, extends, or amends the terms of an existing debt obligation without satisfying and replacing the existing debt obligation, the transaction is not a covered loan. On the other hand, loan assumptions will continue to be covered loans under the new HMDA Rule.

If a transaction meets coverage criteria and is not excludable, the loan will be a covered transaction. The bank must then determine if the transaction is required to be reported. Pursuant to HMDA requirements, a transaction is required to be reported if it's an application for, origination of, or a purchase of a covered loan, as defined by the regulation. An application may include a preapproval request if it meets certain criteria, but it will not include a prequalification request.

As of January 1, 2018, those banks subject to HMDA will be required to collect, record, and report information for those covered transactions (and only those covered transactions) as described above and as further described in the regulation itself.

Data collection and reporting requirements

Effective January 1, 2018, HMDA amends certain existing data points and requires new data points be collected, recorded, and reported for covered loans. Altogether, banks will now be required to submit up to 48 data points, of which 25 of those new. In order to successfully report this data in 2019, a bank should ensure it is properly collecting new and amended data for the calendar year 2018.

According to the CFPB, the data points required to be reported under the final rule can be grouped into four broad categories:

- *Information about applicants, borrowers, and the underwriting process*. For example, age, credit score, debt-to-income ratio, and automated underwriting system results;
- *Information about the property securing the loan*. For example, construction method, property value, and additional information about manufactured and multifamily housing;
- *Information about the features of the loan*. For example, additional pricing information, loan term, interest rate, introductory rate period, non-amortizing features, and the type of loan; and
- *Certain unique identifiers*. For example, universal loan identifier, property address, loan originator identifier, and a legal entity identifier for the financial institution

In addition, the Final Rule amends existing requirements related to the collection of an applicant's or borrower's ethnicity, race, and sex. The new rule requires a bank to identify how such information

[3] For purposes of this article, in describing exclusions from the Rule, "Covered Transactions" refers to a closed-end mortgage loan or open-end line of credit that is otherwise subject to the Rule, absent an exclusion.

was collected – on the basis of visual observation or surname—for in-person applications for which the applicant has not supplied the information. Additionally, where the borrower does provide information related to race and ethnicity, the Rule requires banks to permit applicants and borrowers to self-identify using disaggregated ethnic and racial categories. Aggregation of such information will be appropriate when race and ethnicity data is completed by the financial institution.

All HMDA data points can be found in the 2015 Rule or, for a Summary Reference Chart, visit the CFPB's HMDA Implementation Page, provided below.

Process for reporting and disclosing data

A bank's recording responsibilities remain largely unchanged under the new HMDA rule. A bank is required to record information quarterly for covered loans. More specifically, recording must be completed on one or more LARs within 30 calendar days after the end of the calendar quarter in which the bank took final action on a reportable transaction.

Likewise, the new Rule retains the existing annual reporting requirement. That is, a bank must submit its annual LAR to the appropriate federal agency by March 1 of the year following the calendar year for which data are collected. This submission, however, must now be electronic and submitted in accordance with procedures published by the Bureau. Information related to electronic submission is available on the Bureau's HMDA implementation page. Furthermore, effective in January 2019, a bank must submit certain information about the institution when submitting its 2018 HMDA data (by March 1, 2019), such as its Taxpayer Identification Number (TIN), total number of entries in the submission, and its appropriate federal agency.

Although all banks will continue to be subject to annual reporting requirements, certain banks will be required to report data quarterly. Effective January 1, 2020, banks that reported at least 60,000 Covered Loans and Applications (combined) for the preceding calendar year will be required to report HMDA data on a quarterly basis, in addition to its annual reporting requirement. This quarterly reporting requirement entails submission of required data points within 60 calendar days after the end of the calendar quarter. A bank subject to this quarterly reporting requirement will only be required to submit quarterly data for the first three quarters of the year; it need not submit 4th quarter data, as this information will be reported as part of its annual submission. The annual submission for these banks will include a resubmission of the data previously submitted for the first three quarters of the year (including any corrections to the data), as well as its fourth quarter data.

Disclosure Statement and Modified LAR

The 2015 HMDA Rule does provide some additional regulatory relief for banks in that it is no longer required to publicly provide a disclosure statement and LAR (modified for privacy purposes). Effective in January 2018, banks must now only provide a notice to consumers, upon request of data, that the information is available on the Bureau's website. More specifically, after receiving notification from the FFIEC that a bank's disclosure statement is available, the bank is required, within three business days, to make a written notice available to the public, upon request, conveying that the bank's disclosure statement may be obtained on the Bureau's website. A Sample Notice is provided by the Bureau. These changes apply to data collected in 2017 and beyond.

Additionally, beginning in 2018, written notice must be provided, upon request, regarding the availability of a bank's modified LAR. A Sample Notice is provided by the Bureau. Furthermore, a combined notice can be used to satisfy both disclosure statements. A Sample Notice is provided to do so.

Posted Notices

The new HMDA Rule modifies the existing posting requirement. Effective January 1, 2018, a bank must post a general notice about the availability of HMDA data on the Bureau's website in the lobby of its home office and each branch office physically located in a Metropolitan Statistical Area (MSA) or Metropolitan Division (MD). A Sample Notice is provided by the Bureau. These changes apply to data collected in 2017 and beyond.

As bankers prepare for the upcoming year, it's imperative to consider HMDA. First and foremost, a bank should determine if the financial institution coverage criteria, which become effective in January 2017, serve to exclude the bank from HMDA coverage. If the bank is HMDA-reportable, it would be prudent to use 2017 to prepare for data collection requirements that become effective in 2018 (to be reported in 2019). There will be significant people, process, and technology impacts to address throughout the year, including updating systems requirements, staff training, and updating policies and procedures. Banks should begin addressing these as soon as possible.

Additional information can be found at www.consumerfinance.gov/regulatory-implementation/hmda.

WBA wishes to thank Atty. Lauren C. Capitini, Boardman & Clark, llp for providing this article. ■

Wisconsin Bankers Association

Compliance Journal

Special Focus

CFPB's Prepaid Rule: A Bank Should Review its Account Products to Determine Applicability

Notice 2016-16

On November 22, 2016, the Consumer Financial Protection Bureau (CFPB or Bureau) issued the final Prepaid Rule, providing new protections for consumer prepaid financial products. The Rule introduces significant new disclosure requirements and extends consumer liability protections and error resolution requirements to prepaid accounts by amending Regulation E. The Rule also modifies existing Regulation E requirements for payroll card accounts and government benefit accounts. Additionally, the Rule incorporates Regulation Z protections for prepaid accounts with overdraft credit features. Banks are required to comply with this Rule by October 1, 2017, although the requirement to submit prepaid account agreements to the Bureau, as described below, is effective October 1, 2018.

In order to determine if your bank will be subject to the Prepaid Rule, you must first to determine whether any of the bank's products are within the scope of the Rule. A product will be governed under the Rule if it meets the definition of a "prepaid account." First, although already subject to certain Regulation E protections, payroll card accounts and government benefit accounts are considered "prepaid accounts." A payroll card account is an account established through an employer for the purpose of providing recurring payments of salary, wages, or other compensation to an employee via electronic fund transfer. Whereas a government benefit account is an account established by a government agency to distribute government benefits to a consumer electronically. In addition, the following accounts are considered "prepaid accounts" under the Rule, unless specifically excluded:

- An account that is marketed or labeled as "prepaid" and is redeemable upon presentation at multiple, unaffiliated merchants for goods and services or usable at an ATM;
- An account that meets <u>all</u> of the following elements:
  - Is issued for a pre-paid, specified amount or is capable of being loaded with funds after issuance;
  - Whose primary function is to conduct transactions with multiple, unaffiliated merchants for goods or services, to conduct ATM transactions or to conduct person-to-person (P2P) transfers; and
  - Is not a checking account, share draft account, or a negotiable order of withdrawal (NOW) account.

The following accounts are excluded from coverage:

- Accounts loaded with funds exclusively from a health savings account, flexible spending arrangement, medical savings account, health reimbursement arrangement, dependent care assistance program, or transit or parking reimbursement arrangement;
- An account established (directly or indirectly) through a third party and loaded with qualified disaster relief payments;
- A gift certificate;
- A loyalty, award, or promotional gift card;
- A general-use prepaid card that is both marketed and labeled as a gift card or gift certificate; or
- An account established for distributing needs-tested benefits in a program established under state or local law or administered by a state or local agency.

In addition, the following types of accounts are not governed by the Rule:

- P2P functionality of an account established by/through the U.S. government if the primary function of the account is to conduct closed-loop transactions on U.S. military installations or vessels, or similar government facilities;
- Commercial-purpose account; and
- An account held under a bona fide trust agreement.

If a bank has determined that it offers one or more "prepaid accounts," the Bank should familiarize itself with the new, existing, and modified require-ments that pertain to these accounts. First, pursuant to the Rule, new disclosures are required.

Disclosures

The Pre-acquisition Disclosure

Before a prepaid product is acquired by a consumer, a bank must provide both a short- and long form disclosure in tabular format (the "pre-acquisition disclosures"). The short form disclosure is designed to provide consumers with information related to key fees, features, and terms of the prepaid account prior to the time it's purchased, opened, or the consumer chooses to be paid via a prepaid account (i.e. "acquisition"). The long form disclosure, on the other hand, provides detailed information related to the fees associated with the prepaid account. For a prepaid account acquired at a retail location or by telephone, a long form disclosure can be provided after acquisition. The CFPB provides Model short form disclosures that offer a safe harbor when used accurately and appropriately. Additionally, the Rule includes a Sample long form disclosure that can be used as an example; however, no safe harbor is provided for its use.

The Access Device Disclosure

Additionally, certain disclosures must be provided on the access device itself. For example, if the bank provides a card to access the prepaid account, the card must contain certain disclosures such as the name of the bank, along with a website and telephone number the consumer can use to contact the bank about the prepaid account. If a physical access device is not provided in connection with the prepaid account, these disclosures must be provided on the website, mobile application, or other entry point used by a consumer to access the prepaid account electronically.

Regulation E Initial Disclosures

Furthermore, prepaid accounts are subject to the disclosure scheme under current Regulation E. This requires banks to provide consumers with Regulation E's initial disclosures, with certain modifications as contained in the Rule. For example, the initial disclosure must include all of the information required to be disclosed in the pre-acquisition long form disclosure.

Limitations on Liability and Error Resolution

In addition to the new disclosure regime, Banks must adhere to Regulation E's limitations on liability and error resolution provisions, as modified by the Rule for prepaid accounts. The Rule extends these protections to all prepaid accounts, regardless of whether a financial institution has completed its customer identification and verification process with respect to the account. However, provisional credit for alleged errors is not required for unverified accounts. Once an account is verified, a bank must comply with provisional crediting requirements for both errors that occur prior to and after account verification, within the provisional credit timeframe.

Periodic Statements

Furthermore, the Rule generally requires the provision of periodic statements for prepaid accounts, consistent with Regulation E. However, banks may comply with a periodic statement "alternative" by providing prepaid account users with the following information instead:

- Account balance information made readily available via telephone (and terminal for government benefit accounts);
- Electronic account transaction histories covering at least the preceding 12 months; and
- Written account transaction histories, made available upon request, covering the preceding 24 months

Periodic statements and account transaction histories must also disclose the amount of any fees assessed against the account, and must display a summary total of the amount of all fees assessed by the bank against the prepaid ac-count for the prior calendar month and for the calendar year to date.

Submitting Agreements to CFPB and Website Posting

Additionally, prepaid account issuers, including Banks, must submit prepaid account agreements to the CFPB. With few exceptions, a bank

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must submit any new, amended, or withdrawn agreement within 30 days of offering, amending, or withdrawing such agreement. If the prepaid account agreement that is submitted to the Bureau is offered to the general public, the bank must also make it available in a prominent and readily accessible location on its website. Agreements must be submitted to the Bureau within 30 days of this provision's effective date of October 1, 2018. In contrast, banks should note that the requirement to post a prepaid account agreement on its website is effective October 1, 2017.

Overdraft Credit Features - Regulation Z

Finally, the Rule amends both Regulation Z and Regulation E to regulate prepaid accounts that offer overdraft credit features ("hybrid prepaid-credit cards"). Pursuant to the Rule, any credit feature that can be accessed during the course of a transaction using the prepaid card, with certain exceptions, is subject to Regulation Z's credit card rules. Furthermore, an overdraft credit feature on a prepaid account is required to be structured as a separate credit feature rather than a negative balance to a prepaid account. This separate credit feature will not be considered an "overdraft service" for purposes of Regulation E and thus, no opt-in notices are required.

Overall, the Prepaid Rule brings about enormous changes for prepaid accounts beginning in October 2017. It is imperative for your Bank, first and foremost, to determine if any products currently offered will be subject to these rules as "prepaid accounts." If your bank does offer prepaid accounts, it would be prudent to consider the viability of continuing to offer such products. Finally, if your Bank will continue to offer prepaid accounts as of October 1, 2017, it's important to review the Rule and work to understand your responsibilities as issuer and/or holder of funds for prepaid accounts, prepare your systems, update your policies and procedures, and train your staff. It's advisable to assess and make decisions soon, as the implementation clock is ticking.

Additional information related to the Prepaid Rule can be found on the CFPB's Prepaid Rule Implementation Page at www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/prepaid-rule.

WBA wishes to thank Atty. Lauren C. Capitini, Boardman & Clark llp for providing this article.

Department of Labor Overtime Rule Blocked

Notice 2016-17

Employers have been preparing for the December 1, 2016, effective date of the Department of Labor's new overtime rule which would require certain employees to be paid a minimum of $913 per week ($47,476 annually) to qualify as exempt from the overtime requirements of the Fair Labor Standards Act.

In September, two separate groups of plaintiffs (a group of states and a group of private sector organizations) sued the Department of Labor (DOL) to challenge the rule, and the states sought an emergency injunction to block the rule from going into effect. On November 22, a federal district court judge in Texas granted the emergency injunction to stop the new rule from taking effect. The Court ruled that the DOL has authority to define which employees meet the duties tests under the Fair Labor Standards Act's executive, administrative and professional exemptions, but that authority does not extend to setting a minimum salary standard. The Court determined that because the rule set a minimum salary level, the rule is unlawful and barred the DOL from implementing or enforcing the rule.

The ruling states that the temporary injunction barring the implementation of the rule is nationwide because the rule was to apply in all states and irreparable injury would occur nationwide were the rule to go into effect.

While it was only the state plaintiffs (not the private sector plaintiffs) who sought the emergency injunction, it appears from the decision that the injunction blocking the rule applies to both private and public sector employers. It is important to note that the injunction is preliminary only; it is not a final ruling on the validity of the DOL rule. The judge's opinion states that with the quickly approaching effective date, issuing the injunction will allow the court to render a more meaningful decision on the validity of the rule. We will keep you apprised of further developments in this matter.

We recognize that this decision will be a welcome reprieve for many employers, as well as a source of frustration for those who have worked through and communicated or implemented pay changes in order to comply with the new rule. For now, employers should assess whether they will move ahead with any exemption and pay changes they had planned to implement (or reverse changes already made) or if they will put things on hold pending further developments in this area.

WBA wishes to thank Atty. Jennifer S. Mirus, Boardman & Clark llp, for providing this update. ■

must submit any new, amended, or withdrawn agreement within 30 days of offering, amending, or withdrawing such agreement. If the prepaid account agreement that is submitted to the Bureau is offered to the general public, the bank must also make it available in a prominent and readily accessible location on its website. Agreements must be submitted to the Bureau within 30 days of this provision's effective date of October 1, 2018. In contrast, banks should note that the requirement to post a prepaid account agreement on its website is effective October 1, 2017.

Overdraft Credit Features - Regulation Z

Finally, the Rule amends both Regulation Z and Regulation E to regulate prepaid accounts that offer overdraft credit features ("hybrid prepaid-credit cards"). Pursuant to the Rule, any credit feature that can be accessed during the course of a transaction using the prepaid card, with certain exceptions, is subject to Regulation Z's credit card rules. Furthermore, an overdraft credit feature on a prepaid account is required to be structured as a separate credit feature rather than a negative balance to a prepaid account. This separate credit feature will not be considered an "overdraft service" for purposes of Regulation E and thus, no opt-in notices are required.

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