Wisconsin Bankers Association

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Compliance Journal

Special Focus

Changes to Community Reinvestment Act Proposed by Regulators

On January 9, 2020 the OCC, Treasury, and FDIC (agencies) issued a joint notice of proposed rulemaking (proposed rule) to modernize Community Reinvestment Act (CRA) regulations. The proposed rule contains four main elements designed to encourage banks to serve their communities by making the regulatory framework more objective, transparent, consistent, and easy to understand. Specifically, the agencies have proposed to (1) clarify which activities qualify for CRA credit, (2) update where activities count for CRA credit, (3) create a more transparent and objective method for measuring CRA performance, and (4) provide for more transparent, consistent, and timely CRA-related data collection, recordkeeping, and reporting. Comments on the proposed rule are due March 9, 2020.

Background

Congress enacted the CRA in 1977 with the purpose of encouraging sound lending to all areas of a bank's community. The OCC, FDIC, and Board of Governors of the Federal Reserve have since issued regulations to implement the statute. The proposed rule presents the first major revisions to CRA regulation since 1995.

The agencies have acknowledged that over the past 25 years, technology and the expansion of interstate banking have transformed the financial services industry, how banks deliver their services, and how customers choose to bank. Recognizing the need for modernization, the agencies issued an Advance Notice of Proposed Rulemaking (ANPR) in 2018. WBA, along with bankers, trade groups, and other industries, offered feedback on the CRA framework through comments on the ANPR. Comments discussed how current CRA framework has not kept pace with changes in banking or technology and that the CRA regulations and guidance has become cumbersome, outdated, and complex. WBA's comment letter highlighted points received by member banks, specifically challenges presented when:

- An activity qualifies for CRA credit during one exam, but not the next,
- A bank believes that an activity will receive CRA credit, but does not, and
- A bank is unable to obtain confirmation in advance that an activity will receive credit.

The proposed rule would address these comments by clarifying and expanding what qualifies for CRA credit. That aspect of the rule is discussed below, along with select provisions. Note that this article is intended to summarize key provisions of the proposed rule rather than provide a comprehensive overview. For the complete rule please see the link at the end of the article. This article covers the four main elements of the rule: what counts for CRA credit, where activities count for CRA credit, measuring CRA performance, and CRA-related data collection.

Clarifying and Expanding What Qualifies for CRA Credit

Under the current CRA framework, qualifying activities generally fall into the category of retail banking or community development (CD) activities, depending on various considerations. Most banks face uncertainty as to what types of activities meet those considerations and thus, qualify for CRA credit. The proposed rule aims to remedy this in a few ways. Two are presented below: an expansion upon the definition of "qualifying activities" and the creation of a qualifying activities confirmation process alongside an illustrative list of qualifying activities.

Qualifying Activities Criteria

The proposed rule would define a "qualifying activity" as an activity that helps meet the credit needs of a bank's community, particularly those individuals, areas, and populations with needs. Those criteria generally include activities that currently qualify for CRA credit while establishing the following new categories:

- A retail loan provided to:
  - A low or moderate-income (LMI) individual or family,
  - A small business, or
  - A small farm.
- A retail loan provided in Indian country.
- A retail loan that is a small loan to a business or a small loan to a farm located in a low- or moderate-income census tract.
- A CD activity that provides financing for or supports certain criteria. Examples include:
  - Essential community facilities that partially or primarily benefit or serve LMI individuals or areas of identified need,
  - Family farms,
  - Financial literacy programs or education or homebuyer counseling,
  - See the proposed rule at the end of this article for the complete list.

Qualifying Activities Confirmation and Illustrative List

Under the proposed rule, the agencies would establish an online process for a bank to seek confirmation as to whether an activity qualifies for credit.[1] The agencies would inform the bank whether the activity qualifies, or the activity does not qualify, and then place the activity on a publicly available list. Through this process, the list would contain examples of activities, submitted by banks, that the agencies have determined qualify or do not qualify for credit.

The list would also be revised at least every three years, through a public notice and comment process, to add activities that meet the criteria and to remove activities that no longer meet the criteria (e.g., if broadband were universally available and no longer considered to be essential infrastructure). An initial proposed list is available on the agencies' websites and in section IV of the proposed rule.

Expanding Where CRA Activity Counts

Assessment areas under current CRA rules depend on brick-and-mortar bank locations, creating difficulties for reaching outside that area. The agencies have proposed to address this by creating two categories of assessment areas: "facility-based" and "deposit-based."

Facility-Based Assessment Area

The proposed rule requires banks to delineate an assessment area encompassing each location where the bank maintains a main office, a branch, or a non-branch deposit-taking facility as well as the surrounding locations in which the bank has originated or purchased a substantial portion of its qualifying retail loans. The area must consist of:

- One whole metropolitan statistical area (using the metropolitan statistical area boundaries that were in effect as of January 1 of the calendar year in which the delineation is made),

1 This process would be optional, and banks would not be required to use this process.

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- The whole nonmetropolitan area of a state,
- One or more whole, contiguous metropolitan divisions in a single metropolitan statistical area (using the metropolitan division boundaries that were in effect as of January 1 of the calendar year in which the delineation is made), or
- One or more whole, contiguous counties or county equivalents in a single metropolitan statistical area or nonmetropolitan area.

Deposit-Based Assessment Area

The proposed rule would require banks that receive more than 50 percent of their retail domestic deposits from outside of their facility-based assessment areas to delineate separate, non-overlapping "deposit-based" assessment areas in the smallest geography where they receive five percent or more of their retail domestic deposits. These deposit-based assessment areas must be delineated to consist of:

- One whole state,
- One whole metropolitan statistical area (using the metropolitan statistical area boundaries that were in effect as of January 1 of the calendar year in which the delineation is made),
- The whole nonmetropolitan area of a state,
- One or more whole, contiguous metropolitan divisions in a single metropolitan statistical area (using the metropolitan division boundaries that were in effect as of January 1 of the calendar year in which the delineation is made),
- The remaining geographic area of a state, metropolitan statistical area, nonmetropolitan area, or metropolitan division other than where it has a facility-based assessment area, or
- One or more whole, contiguous counties or county equivalents in a single metropolitan statistical area or nonmetropolitan area.

Activity Outside of Assessment Area

The proposed rule would permit banks to receive CRA credit for qualifying activities conducted outside of their assessment areas at the bank level. Under this approach, banks would still be encouraged to meet local community needs where they have branches and depositors but would be given flexibility to serve other communities with distinct needs as these activities would be considered when calculating the overall dollar value of their qualifying activities under the proposed rule. The goal of this framework would be to reduce the number of areas where there are more banks that want to engage in CD activities than there is need for those activities (known as CD hot spots) and areas where there is a great need for CD activities but few banks that engage in those activities (known as CD deserts).

Providing an Objective Method to Measure CRA Activity

Current CRA regulations evaluate a bank's CRA performance on generally undefined terms through a relatively unspecified process. The proposed rule would attempt to provide a more objective, clear, and consistent assessment by establishing new, general performance standards for institutions that are not small banks. Small banks could opt into the general performance standards, while those that do not would be evaluated under the small bank performance standards consistent with current regulation.

Under the general performance standards, banks would receive a presumptive rating based on what performance standards are met within a given category. Banks would be evaluated on CRA performance at a bank-level and in each assessment area. The bank-level performance standards are based upon:

- CRA evaluation measures,
- Assessment area ratings (see below), and
- Community development minimums.

The assessment area performance standards are based upon:

- Retail lending distribution tests,
- CRA evaluation measures, and
- Community development minimums.

CRA Evaluation Measure

A bank's bank-level CRA evaluation measure is the sum of:

- The bank's annual bank-level qualifying activities values[2] divided by the average quarterly value of the bank's retail domestic deposits as of the close of business on the last day of each quarter for the same period used to calculate the annual qualifying activities value, and
- The number of the bank's branches located in low- or moderate-income census tracts, distressed areas, underserved areas, and Indian country divided by its total number of branches as of the close of business on the last day of the same period used to calculate the annual qualifying activities value multiplied by .01.

A bank's assessment area CRA evaluation measure is determined in each assessment area and is the sum of:

- The bank's annual assessment area qualifying activities value divided by the average quarterly value of the bank's assessment area retail domestic deposits as of the close of business on the last day of each quarter for the same period used to calculate the annual assessment area qualifying activities value,
- The number of the bank's branches located in low- or moderate-income census tracts in the assessment area divided by its total number of branches in the assessment area as of the close of business on the last day of the same period used to calculate the annual assessment area qualifying activities value multiplied by .01, and
- Annual assessment area CRA evaluation measures for each year in the evaluation period, separately for each assessment area.

Retail Lending Distribution Tests

The retail lending distribution tests would evaluate a bank's originations in each assessment area using both a geographic distribution test and a borrower distribution test. Both the geographic distribution test and the borrower distribution test would apply for small loans to businesses and farms. The borrower distribution test would apply, in addition, for home mortgage and consumer lending.

To pass the geographic distribution test for both the small loan to a business product line and the small loan to a farm product line, a bank's percentage of such loans in low- or moderate income census tracts originated during the evaluation period in the assessment area must meet or exceed the threshold established for either the associated geographic demographic comparator or the associated geographic peer comparator.

- The geographic demographic comparator threshold is 55 percent of the percentage of businesses or farms in low- and moderate-income census tracts in the assessment area.
- The geographic peer comparator threshold is 65 percent of the percentage of small loans to businesses or farms in low- and moderate income census tracts originated by all banks evaluated under the general performance standards.

To pass the borrower distribution test for the home mortgage lending product line, a bank's percentage of home mortgage loans to low- and moderate income individuals and families originated during the evaluation period in the assessment area must meet or exceed the threshold established for either the associated borrower demographic comparator or the associated borrower peer comparator.

2 To better understand "bank-level qualifying activities" the proposed rule provides an example: [qualifying loans on balance sheet for at least 90 days and CD investments] + [twenty five percent of the origination value of qualifying loans sold within 90 days of origination] = [CD services and monetary and in-kind donations].

- The borrower demographic comparator threshold is 55 percent of the percentage of low- and moderate income families in the assessment area.

- The demographic peer comparator threshold is 65 percent of the percentage of home mortgage loans to low- or moderate-income individuals and families originated by all banks evaluated under the general performance standards.

Community Development Minimum

The community development minimum would be determined by taking the quantified value of community development loans and community development investments in the assessment area during the evaluation period, divided by the average quarterly value of the bank's assessment area retail domestic deposits as of the close of business on the last day of each quarter of the evaluation period. To achieve a rating of outstanding or satisfactory, this value must meet or exceed 2 percent.

Data Collection, Recordkeeping, and Reporting

Reporting The current CRA framework requires banks to collect and report a variety of data on loans. However, small banks, as defined under the current rule, generally are exempt from these requirements. The current framework also does not collect data on all CRA activity. Under the proposed rule, there would be separate data collection and reporting requirements for banks subject to the general performance standards and for banks subject to the small bank performance standards. Banks evaluated under the general performance standards would be required to collect and maintain extensive information such as retail lending distribution tests results, CRA evaluation measures calculations, and presumptive ratings determinations. Banks would also be required to collect and maintain records of all qualifying and non-qualifying retail loans, assessment area lists, qualifying activities data, and the location of retail loans, and retail domestic deposit data.

Conclusion

The proposed rule is the industry's opportunity to comment on its experiences under current CRA, and what it would like to see in a new rule. The Federal Reserve did not join on the proposed rule, but has indicated its own plans to update its CRA regulations. As the process continues, with House Financial Services hearings being conducted in January of 2020, WBA will continue to monitor all activity on CRA reform to keep its membership informed. WBA plans to submit comments on the proposed rule. To craft a meaningful comment letter, WBA encourages banks to provide us with their thoughts and concerns. In addition, WBA encourages all members to consider writing comments on the proposed rule their own.

The proposed rule can be found by clicking here.

To assist WBA in crafting a meaningful comment letter, reach out to WBA's **Scott Birrenkott** at: sbirrenkott@wisbank.com ■

Summary of Recently Enacted State Legislation

There are several recently enacted state legislative items which impact financial institutions. The following article discusses select aspects of three laws that have been passed this session. For more comprehensive information on each law, please review the applicable Act, each of which is included at the end of this article. This article is focused on law that has been passed. At time of this article's publication, the legislature is still in session. Bills that are later signed into law will be discussed in future publications.

Financial Institutions Modernization Act

The Financial Institutions Modernization Act, or Omnibus Bill, implemented by 2019 Wisconsin Act 65, is a piece of legislation that makes several changes to statutes relating to banking practices. Each change is presented with both a summary and detailed explanation below.

- The borrower demographic comparator threshold is 55 percent of the percentage of low- and moderate income families in the assessment area.

- The demographic peer comparator threshold is 65 percent of the percentage of home mortgage loans to low- or moderate-income individuals and families originated by all banks evaluated under the general performance standards.

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The community development minimum would be determined by taking the quantified value of community development loans and community development investments in the assessment area during the evaluation period, divided by the average quarterly value of the bank's assessment area retail domestic deposits as of the close of business on the last day of each quarter of the evaluation period. To achieve a rating of outstanding or satisfactory, this value must meet or exceed 2 percent.

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Banking Review Board

Summary: Combines the Banking Review Board with the Savings Institutions Review Board into a single Banking Institutions Review Board.

Detailed Explanation: The Wisconsin Department of Financial Institutions has two five-member boards which advise DFI's division of banking. The Banking Review Board advises and reviews administrative actions on matters related to banks and banking. The Savings Institution Review Board advises and reviews administrative actions on matters related to savings banks and savings and loan associations. This provision combines both authorities and purposes into a single review board.

Lost, Destroyed, or Stolen Cashier's Check

Summary: Reduces the period, from 90 days to 30 days, after certain checks or issued, during which the issuing bank must pay the item after it has been claimed as lost, stolen, or destroyed.

Detailed Explanation: The Wisconsin Uniform Commercial Code Section 403.312 describes the procedure by which a financial institution may place a stop payment on a lost, destroyed, or stolen cashier's check, teller's check, or certified check. Under that procedure, a claim to such an item becomes enforceable, generally, on the 90th day following the date of the check. Meaning, that a financial institution must, generally, pay an item claimed as lost, destroyed, or stolen if it is presented during the 90 day period following the date of the check or risk liability for an improper stop payment. This provision reduces that period from 90 days to 30 days.

Mortgage Loan Originators

Summary: Provides temporary authority to act as a mortgage loan originator (MLO) while a license application is pending.

Detailed Explanation: This provision gives temporary authority to act as an MLO to an individual who applies to DFI for a license so long as that individual is employed by a licensed mortgage banker or mortgage broker and was a registered MLO in another state under certain conditions and time requirements. In addition, the individual must not have been previously denied a license, subject to a cease and desist by the Bureau of Consumer Financial Protection (CFPB), and not been convicted of a disqualifying crime. If eligible, the temporary authority beings when the individual furnishes application information to the NMLSR and ends upon the earlier of DFI granting or denying the license, withdrawal of the application for an MLO license, the application is determined to be incomplete, or the license is granted. During the temporary period, the individual is considered to be associated with the mortgage banker or mortgage broker employing them and is considered to have MLO authority subject to all applicable requirements and duties.

Possession of Property Subject to Garnishment

Summary: Grants financial institutions two business days to respond to certain legal process.

Detailed Explanation: A garnishee financial institution in possession of property subject to garnishment is liable for the surrender of that property only upon expiration of two business days to comply with or respond to the garnishee summons and complaints.

Data Processing Services Provided to Financial Institutions

Summary: A financial institution retains property rights of any data transferred to an independent data processing servicer.

Detailed Explanation: Under this provision an independent data processing servicer is an entity that provides to a financial institution electronic data processing services. It excludes the exchange of data and settlement of funds between unaffiliated financial institutions through terminals, remote service units, and customer bank communications terminals. If a financial institution transfers data to an independent data processing servicer, the financial institution retains all right, title, interest, and legal claim to the data. The transfer only permits temporary control of the data for purposes of the contracted services. This provision also places required contract disclosures upon data processing servicers.

Federal Home Loan Bank Loans

Summary: Eliminates certain limitations on loans to state banks made by a Federal Home Loan Bank.

Detailed Explanation: This provision eliminates the current 20-year term limitation and the limitation on the value of bank assets that may be pledged as collateral by a Federal Home Loan Bank.

Effective Date

The Omnibus Bill became effective November 27, 2019, except for three provisions. The provisions creating the banking institutions review board takes effect on May 2, 2021. The provisions affecting licensing and employment transition for MLOs took effect on November 28, 2019. The provisions for independent data processing servicers takes effect on March 1, 2020.

Industrial Hemp

2019 Wisconsin Act 68 was enacted to make several changes to the law governing industrial hemp. Act 68 aligns Wisconsin law to be consistent with the 2018 Federal Farm Bill. An important consideration for banks to keep in mind is that Act 68 directs the Wisconsin Department of Agriculture, Trade and Consumer Protection (DATCP) to write new rules. It is WBA's understanding that DATCP will continue under the 2014 Farm Bill provisions, and existing Wisconsin regulation at the time of this article's publication, in 2020. DATCP is preparing to write rules pursuant to Act 68 and expects to begin the new program in 2021. Select provisions from Act 68 are included below.

- The term "hemp" instead of "industrial hemp" is used, which is defined as "Cannabis sativa L." and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9-tetrahydrocannabinol (THC) concentration of not more than 0.3 percent on a dry weight basis or the maximum concentration allowed under federal law up to 1 percent, whichever is greater."

- No person may produce hemp in Wisconsin without a license from DATCP if required under federal law.

- DATCP is provided authority to establish procedures for the following:

    - Maintaining information relating to hemp production,
    - Testing for THC concentrations in hemp,
    - Disposing of hemp plants grown illegally,
    - Complying with enforcement provisions, and
    - Conducting annual inspections of hemp producers.

- Redefines "marijuana," for the purposes of the controlled substances act, to exclude hemp.

- Excludes THC contained in hemp from the list of Schedule I controlled substances.

- Changes the current hemp pilot program under DATCP to a permanent program and sunsets the pilot program.

- Allows DATCP to set criteria for approving persons to undertake any sampling and testing of hemp that DATCP requires by rule and to approve persons that meet the criteria.

- Requires DATCP to issue a fit for commerce certificate after hemp is tested, or if DATCP determines that hemp is not required to be tested.

- Allows a person, whose personally identifying information relating to the hemp program is in DATCP's possession, to authorize the disclosure of that information.

Agricultural Development Loan Guarantee Program

2019 Wisconsin Act 62 (Act 62) creates a pilot loan guarantee program under the Agricultural Development Loan Guarantee Program administered by the Wisconsin Housing and Economic Development Authority (WHEDA) along with other changes.

Specifically, Act 62 makes the following changes to WHEDA's existing Agricultural Development Loan Guarantee Program:

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- The term of a loan guarantee may not exceed ten years for land and buildings, five years for inventory, equipment, and machinery, and two years for permanent working capital and marketing expenses.

- The closing fee for a loan guarantee under the program may not exceed 1.5 percent.

Act 62 requires WHEDA to allocate $3,000,000 to the pilot program. WHEDA may guarantee collection of 25 percent of the principal of an eligible loan or $750,000, whichever is less. The fixed amount guaranteed is payable to the lender for the entire term of the guarantee. Otherwise, a loan guarantee under the pilot program is subject to all prior requirements. The pilot program sunsets as of July 1, 2024.

Conclusion

In general, recent legislative activity has been favorable for the banking industry. WBA will continue to monitor existing bills and update the membership on any significant changes. If you have any additional questions on any of the above laws, do not hesitate to contact us at wbalegal@wisbank.com.

Click here for Act 65.

Click here for Act 68.

Click here for Act 62. ■

Regulatory Spotlight

Agencies Finalize Regulatory Capital Treatment for High Volatility Commercial Real Estate (HVCRE) Exposures.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) are adopting a final rule to revise the definition of "high volatility commercial real estate (HVCRE) exposure" in the regulatory capital rule. This final rule conforms this definition to the statutory definition of "high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan," in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). The final rule also clarifies the capital treatment for loans that finance the development of land under the revised HVCRE exposure definition. The final rule is effective **04/01/2020**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2019-12-13/pdf/2019-26544.pdf. *Federal Register*, Vol. 84, No. 240, 12/13/2019, 68019-68034.

Agencies Finalize Amendment to Community Reinvestment Act Regulations.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) are amending their Community Reinvestment Act (CRA) regulations to adjust the asset-size thresholds used to define "small bank" or "small savings association" and "intermediate small bank" or "intermediate small savings association." As required by the CRA regulations, the adjustment to the threshold amount is based on the annual percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI–W). The rule is effective **01/01/2020**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2019-12-30/pdf/2019-27288.pdf. *Federal Register*, Vol. 84, No. 249, 12/30/2019, 71738-71740.

Agencies Propose Community Reinvestment Act Regulations.

The Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) propose regulations that could encourage banks to provide billions more each year in Community Reinvestment Act-qualified lending, investment, and services by modernizing the Community Reinvestment Act (CRA) regulations to better achieve the law's underlying statutory purpose of encouraging banks to serve their communities by making the regulatory framework more objective, transparent, consistent, and easy to

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Transitioning Away from LIBOR

Globally, the London Interbank Offered Rate (LIBOR) is one of the most widely used interest rate benchmarks. However, this benchmark may cease to exist at the end of 2021, necessitating a transition away from LIBOR. This article briefly discusses the reasons why LIBOR may be ending and then concentrates on how financial institutions should prepare for its potential end.

The End of LIBOR

LIBOR is calculated as the average of interest rates that a panel of large London banks report that they would charge other banks to borrow unsecured for a specified period of time. Despite LIBOR's widespread use as a reference rate by financial institutions, its reliability and sustainability has been called into question in recent years for a number of different reasons.

Concerned that LIBOR was becoming less stable and reliable, the Financial Conduct Authority (FCA), the United Kingdom's financial regulator, announced that by the end of 2021, it would no longer compel banks to report their interest rates to the LIBOR administrator. The FCA also explained that although it would no longer require banks to submit their rates to the administrator, it would not prohibit banks from continuing to submit their LIBOR data after 2021. LIBOR's administrator has stated that it will continue to calculate LIBOR as long as at least five banks continue to submit their information. This means that LIBOR may continue to exist after 2021; however, the rate will no longer be representative of the inter-bank interest rate offered and accepted by major financial institutions. There are also fears that this number would be more volatile. This occurrence has been referred to as the "zombie LIBOR."

The FCA's announcements have made the future of LIBOR uncertain but clarified the increasing risk associated with continued reliance on LIBOR. With the uncertain future of LIBOR, financial institutions should prepare for the either the retirement or instability of LIBOR.

Transition from LIBOR to SOFR

Based on the potential problems with LIBOR in 2021, market participants and regulators have worked to identify the best alternative reference rate to replace LIBOR and implement plans to transition to that reference rate. The Federal Reserve convened the Alternative Reference Rates Committee (ARRC) to identify a more robust reference rate and to facilitate the transition way from LIBOR. The ARRC is composed of many private-sector entities that have a presence in markets that are impacted by LIBOR. Further, several federal regulators, including the FDIC, the Federal Reserve, the OCC, and the CFPB, serve as non-voting, ex officio members of the ARRC.

In 2017, the ARRC identified the Secured Overnight Financing Rate (SOFR) as its recommended best alternative to LIBOR. SOFR is based on transactions in the U.S. Treasury repurchase market, measuring the cost of borrowing cash overnight collateralized by U.S. Treasury securities in the market. Because of the size and liquidity of the market underlying SOFR, the ARRC believes that the index is more robust and resilient than LIBOR. To support the transition to SOFR, the ARRC has begun implementing steps to help SOFR gain momentum. As a part of this work, in April 2018, the New York Federal Reserve Board began publishing SOFR in conjunction with the Office of Financial Research.

Following the selection of SOFR as its alternative reference rate, the ARRC also published a Paced Transition Plan that outlines specific steps and timelines to promote the adoption of SOFR. These steps focus on updating existing contracts that cite LIBOR as the reference rate and encouraging the issuance of new products that use SOFR. The ARRC has supported the issuance of SOFR-linked products and securities. Recognizing the importance of updating existing contracts that use LIBOR as a reference rate, the ARRC has developed guiding principles for fallback contract language. Following this, the ARRC released recommended fallback contract language for several products including adjustable-rate mortgages and floating-rate notes.

On November 15, 2019, Fannie Mae and Freddie Mac announced their support of the ARRC's fallback language and their plan to incorporate the recommended language into its uniform notes and other legal documents for ARMs. They also announced their plan to offer new SOFR-based index and ARM products and have now become regular issuers of SOFR-indexed debt. Similarly, on February 5, 2020, Fannie Mae and Freddie Mac announced that they had incorporated the ARRC's fallback language into their existing standard ARM notes and riders. Further, they announced that, by the end of 2020, they will no longer acquire loans indexed to LIBOR.

Planning for the End

Given either the upcoming end or instability of LIBOR, financial institutions should prepare for 2022. Institutions should use the next two years to comprehensively assess their risks and develop an action plan to mitigate those risks. It might be best to appoint one person to head the financial institution's strategy and implementation. First, financial institutions should review their existing agreements that use LIBOR as a reference rate. The existing agreements should be divided into those in which a third party is involved, i.e., trust preferred securities or swap agreements, and those in which the financial institution and the other contracting party are the only parties to the transaction (the In-House Contracts).

Any financial institutions that have issued debt securities (such as subordinated debt or trust preferred securities) at the holding company or bank level should check the documentation governing those issuances. Typically, those contracts provide for the substitution of a comparable rate. Financial institutions should confirm the substitution language and also review the procedures for substituting the rate. If the issuance involves an institutional trustee, such as Wilmington Trust Company for many outstanding trust preferred securities, it may be necessary or advisable to contact the institutional trustee far in advance of the LIBOR end to discuss the process of changing rates.

The In-House Contracts should be further subdivided into those whose term ends prior to the end of 2021 and those whose maturity is after 2021. Next, financial institutions should ensure that existing In-House Contracts are able to substitute a comparable rate. Then, the financial institution should determine whether it will substitute a new rate and a new margin and at what point the change will be made. Consideration should be given to the stability of a new rate and a new margin. The decision on a new rate and a new margin may involve several committees and personnel at the financial institution as different considerations of interest rate risk, stability, competition and other factors will influence the ultimate substitute reference rate the financial institution will utilize. Financial institutions should note that the Prime Rate will continue to be available unaffected by the impending demise of LIBOR.

After a decision has been made on the financial institution's new reference rate, it may be advisable to educate the financial institution's LIBOR customers on the new rate, especially if it's a rate that customers may not be familiar with. Although a customer may not have the right to contest the new reference rate, educating the customer may alleviate the customer's anxiety about the new reference rate.

Finally, the financial institution should determine how the new reference rate will be implemented. The financial institution should consider whether it will draft amendments to existing loan documents to implement the new reference rate or whether it will simply notify the other party to the contract of the new reference rate. Financial institutions should contact their legal counsel for advice on this issue.

The WBA forms distributed through FIPCO currently contain a provision that if the index rate a lender uses with respect to a particular loan becomes unavailable then the lender may substitute a comparable index rate. To alleviate concerns with the zombie LIBOR, FIPCO has created the LIBOR Addendum. This Addendum allows the lender to replace LIBOR if a "Replacement Event" occurs. The Addendum is drafted to define a Replacement Event to include a situation in which LIBOR would continue to exist in a zombie state. The LIBOR Addendum can be used for new loans that use LIBOR as the index rate. The form could also be used for existing loans, but the borrower is required to sign the LIBOR Addendum.

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When making new loans using LIBOR that will mature after 2021, financial institutions should ensure that any new contracts allow for an easy transition to a new reference rate. Consideration should be given to using the LIBOR Addendum to In-House Contracts. Additionally, financial institutions should consider incorporating the fallback language adopted by Fannie Mae and Freddie Mac to any residential real estate mortgages using LIBOR intended to be sold on the secondary market.

Taking the steps outlined above will help financial institutions mitigate their risks in the post-LIBOR market.

WBA wishes to thank Atty. Catherine Wiese, Boardman & Clark, llp for providing this article. ■

Regulatory Spotlight

Agencies Finalize Standardized Approach for Calculating the Exposure Amount of Derivative Contracts.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) are issuing a final rule to implement a new approach—the standardized approach for counterparty credit risk (SA–CCR)—for calculating the exposure amount of derivative contracts under these agencies' regulatory capital rule. Under the final rule, an advanced approaches banking organization may use SA–CCR or the internal models methodology to calculate its advanced approaches total risk-weighted assets, and must use SA–CCR, instead of the current exposure methodology, to calculate its standardized total risk-weighted assets. A non-advanced approaches banking organization may use the current exposure methodology or SA–CCR to calculate its standardized total risk-weighted assets. The final rule also implements SA–CCR in other aspects of the capital rule. Notably, the final rule requires an advanced approaches banking organization to use SA–CCR to determine the exposure amount of derivative contracts included in the banking organization's total leverage exposure, the denominator of the supplementary leverage ratio. In addition, the final rule incorporates SA– CCR into the cleared transactions framework and makes other amendments, generally with respect to cleared transactions. The final rule is effective 04/01/2020, and the mandatory compliance date is **01/01/2022**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-01-24/pdf/2019-27249.pdf. *Federal Register*, Vol. 85, No. 16, 01/24/2020, 4362-4444.

Agencies Finalize Regulatory Capital Rule Revisions.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) are issuing a final rule to implement section 402 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. Section 402 directs these agencies to amend the regulatory capital rule to exclude from the supplementary leverage ratio certain funds of banking organizations deposited with central banks if the banking organization is predominantly engaged in custody, safekeeping, and asset servicing activities. The rule is effective **04/01/2020**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-01-27/pdf/2019-28293.pdf. *Federal Register*, Vol. 85, No. 17, 01/27/2020, 4569-4579.

Agencies Request Comment on Information Collection.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) seek comment on the information collection titled Call Report. The agencies also gave notice that they sent the collection to OMB for review. Comments are due **02/26/2020**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-01-27/pdf/2020-01292.pdf. *Federal Register*, Vol. 85, No. 17, 01/27/2020, 4780-4796.

CFPB Requests Applications for Advisory Committee Membership.

The Bureau of Consumer Financial Protection (CFPB) invites the public to apply for membership for appointment to its Consumer Advisory Board (CAB), Community Bank Advisory Council (CBAC), Credit Union Advisory Council (CUAC), and Academic Research Council (ARC) (collectively, advisory committees). Membership of the advisory committees includes representatives of consumers, diverse communities, the financial services industry, academics, and economists. Appointments to the committees are generally for two years. However, the Director may amend the respective committee charters from time to time during the charter terms, as the Director deems necessary to accomplish the purpose of the committees. CFPB expects to announce the selection of new members in late summer 2020. Applications are due **02/27/2020**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-01-13/pdf/2020-00308.pdf. *Federal Register*, Vol. 85, No. 8, 01/13/2020, 1806-1807.

Wisconsin Bankers ASSOCIATION

March 2020

Compliance Journal

Special Focus

The COVID-19 pandemic has brought about significant disruption in all areas, including bank operations. WBA has created and collected the below resources on bank compliance in this unprecedented time. At the time of publication, all items are accurate but due to the constantly changing nature of the pandemic, these items may become outdated. Rest assured, WBA will continue to update its members on any regulatory changes as a result of the COVID-19 pandemic. The latest information can be found online at wisbank.com/coronavirus.

Federal and State COVID-19 Related Guidance

Over the past three weeks, federal and state banking agencies have issued several items concerning the coronavirus (COVID-19) and its impact on financial institutions and their customers. This article is meant to help provide a timeline of some of the issuances and short briefing of the topics covered. The following is not an exhaustive list as the agencies continue to release new guidance and resources even after this publication is released.

Federal Agency Statements to Work with Customers

In early March, the federal banking agencies issued a statement encouraging financial institutions to meet the financial needs of their customers affected by COVID-19. The agencies stated recognition that financial institutions may face staffing and operational challenges and noted that financial institutions should work constructively with borrowers and other customers in affected communities. The release may be viewed at: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200309a.htm.

FDIC, FRB, and OCC next released individual statements to provide more specific examples of what financial institutions could consider when working with their affected customers and communities. Examples provided by the agencies include waiving certain fees, such as: (a) ATM fees for customer and non-customers; (b) overdraft charges; (c) late payment fees on credit cards and other loans; and (d) early withdrawal penalties on time deposits.

Other efforts identified by the agencies include: (a) increasing ATM daily cash withdrawal limits; (b) easing restrictions on cashing out-of-state and non-customer checks; (c) increasing credit card limits for creditworthy borrowers; (d) offering payment accommodations, such as allowing borrowers to defer or skip some payments or extend the payment due date, which would avoid delinquencies and negative credit bureau reporting; and (e) working with consumers who are temporarily unable to work due to temporary business closures, slowdowns, or sickness.

All three agencies recognize financial institutions may need to offer loan modifications to those who are experiencing temporary hardships as a result of COVID-19 related issues. Each agency has stated that modifications should be based upon the facts and circumstances of each borrower and loan. The agencies have also stated that all will be flexible in working with banks who are implementing prudent loan workout arrangements with affected borrowers.

The three agencies have also stated each are willing to assist institutions that are having difficulty meeting reporting responsibilities. The agencies have instructed institutions to work closely with their regional regulatory office. Financial institutions should review their federal regulator's statement for more specific instruction. FDIC's FIL-17-2020 may be viewed at: https://www.fdic.gov/news/news/financial/2020/fil20017.html. FRB's SR 20-4 and CA 20-3 may be viewed at: https://www.federalreserve.gov/supervisionreg/srletters/SR2004.htm. OCC's Bulletin 2020-15 may be viewed at: https://www.occ.gov/news-issuances/bulletins/2020/bulletin-2020-15.html.

Loan Modifications

On March 22, 2019, FRB, FDIC, OCC, CFPB, NCUA, and CSBS jointly issued an Interagency Statement on Loan Modifications and Reporting for Financial Institutions with Customers Affected by the Coronavirus. In the guidance, the agencies stated they will not criticize institutions for working with borrowers and will not direct supervised institutions to automatically categorize all COVID-19 related loan modifications as troubled debt restructurings (TDRs). The agencies also provided instruction regarding accounting for loan modifications. The instruction includes confirmation from FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who are current prior to any relief, are not TDRs. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. The guidance also states that financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral. The interagency statement may be viewed at: https://www.fdic.gov/news/news/press/2020/pr20038a.pdf.

FinCEN Guidance

In mid-March, FinCEN issued a notice requesting financial institutions affected by COVID-19 to contact FinCEN and their functional regulator as soon as practicable if the institution has concern about any potential delays in its ability to file required BSA reports. Institutions should contact FinCEN's Regulatory Support Section 1-800-949-2732 and selection option 6 or email at FinCEN at: FRC@fincen.gov. FinCEN has also advised institutions to remain alert about malicious or fraudulent transactions similar to those that occurred in the wake of natural disasters, including: imposter scams, investment scams, product scams, and COVID-19-related insider trading.

For SARs linked to COVID-19, along with checking the appropriate SAR-template box(es) for certain typologies, FinCEN also encourages banks to enter "COVID19" in Field 2 of the SAR-template. The statement may be viewed at: www.fincen.gov/news/news-releases/financial-crimes-enforcement-network-fincen-encourages-financial-institutions.

Federal Agencies Recommend Use of Capital; Propose Change to Definition of "Eligible Retained Income" Under Capital Rules

Also in mid-March, FDIC, FRB, and OCC issued a notice encouraging financial institutions to use their capital and liquidity buffers as they respond to the challenges presented by the effects of COVID-19. The agencies stated the higher capital and liquidity buffers imposed over the past several years were designed to provide financial institutions with the means to support the economy in adverse situations and allow the institutions to continue to serve households and businesses. The federal agencies also stated support of banking organizations that choose to use their capital and liquidity buffers to lend and undertake other supportive actions in a safe and sound manner. The statement may be viewed at: https://www.fdic.gov/news/news/press/2020/pr20030.html.

On the same day as the above notice was issued, the agencies also released an interim final rule which will change the current bank capital rules. In light of recent disruptions in economic conditions caused by COVID-19 and current strains in U.S. financial markets, the agencies issued the interim final rule to revise the definition of "eligible retained income" for all depository institutions, bank holding companies, and savings and loan holding companies subject to the agencies' capital rule. The revised definition of eligible retained income will make any automatic limitations on capital distributions that could apply under the agencies' capital rules more gradual. The interim final rule will be effective upon publication of the interim rule in the Federal Register. The interim final rule is effective March 20, 2020. Comments are due May 4, 2020. The interim final rule may be viewed at: https://www.fdic.gov/news/news/press/2020/pr20030.html.

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FDIC FAQs for Banker and Consumers

On March 18th, FDIC issued two sets of frequently asked questions (FAQs). One series is aimed to help answer COVID-19 related questions of consumers; the second series of questions are topics related to bank operations and filings. Both FAQs may be found at: https://www.fdic.gov/coronavirus/index.html.

State Agency Statement and Issuances

Wisconsin's DFI has also issued a statement as a result of COVID-19. On March 18th, in connection with Governor Ever's declaration of a health emergency, DFI issued a letter to support and reinforce the FFIEC Pandemic Preparedness Guidance issued March 6, 2020. DFI also stated it recognizes the potential impact of COVID-19 on bank customers and operations. DFI stated it will work with affected financial institutions to provide appropriate regulatory assistance as needed. DFI also instructed banks to inform their DFI Division of Banking supervisor, or call (608) 261-7578, if any changes are made to public access at a financial institution due to COVID-19 concerns.

On March 17, 2020, Wisconsin's DHS issued Emergency Order #5 to prohibit mass gatherings of 10 people or more to slow the spread of COVID-19. An exemption to the order is an office space so long as social distancing is in place. DFI issued a letter to bank executives dated March 18, 2020, stating banks are exempt from the DHS emergency order: https://www.wdfi.org/_resources/indexed/site/fi/banks/20200318_COVID-19_BankLetter_DFI-BankAdministrator_vFINAL.pdf.

Under Wisconsin law, licensed mortgage loan originators can only work from certain locations. To assist with virus mitigation efforts, DFI has issued a directive concerning licensed mortgage loan originators in response to COVID-19. DFI stated in its directive that licensed mortgage loan originators may work from home, whether located in Wisconsin or another state, even if the home is not a licensed or registered office or branch office of the sponsoring mortgage banker, mortgage broker, or registered entity. This action may be permissible if certain criteria are met as outlined on DFI's mortgage banking website: http://www.wdfi.org/fi/mortbank/default.htm.

On March 24, 2020, Governor Evers, through his designee, DHS Secretary Andrea Palm issued Emergency Order #12, "Safer at Home" which became effective at 8 a.m. on Wed, March 25 and ends at 8 a.m. Friday, April 24 (unless superceded sooner). The banking industry is exempt from the order since it is deemed an essential business. This is accomplished in two ways under the order. First, it is a reference to the US. Department of Homeland Security's Cybersecurity and Infrastructure Security Agency (CISA) guidance as to the 16 categories of "Essential Critical Infrastructure Workers during the COVID-19 Response." Second, banks are also separately and specifically identified in Section 13(l) of the most recently issued order. The order may be viewed at: https://evers.wi.gov/Documents/COVID19/EMO12-SaferAtHome.pdf.

Conclusion

Both federal and state banking agencies have issued guidance related to COVID-19 and its impact on financial institutions and their customers. WBA has created a COVID-19 Resources webpage to keep updated, relevant COVID-19 information in a centralized and organized place. The resource page may be viewed at: https://www.wisbank.com/resources/coronavirus-covid-19/.

Wisconsin Department of Financial Institution's Emergency Guidance on Remote Notarization

On March 18, 2020 the Wisconsin Department of Financial Institutions (DFI) issued emergency guidance on remote notarization (guidance). Individuals who need documents notarized remotely may use a DFI-approved remote online notarization provider.

Summary

Generally speaking, a person seeking notarization must "appear" before a notary public and in the "presence" of witnesses. As of publication of this article, DFI has issued guidance that, until further notice, it will construe the terms "appear" and "presence" to include appearances by remote live audio and video connection.

Conclusion

While Act 125 provides standards for remote notarization, it requires implementation by rulemaking by DFI. DFI's emergency guidance on remote notarization permits operation under the standards while the guidance remains in effect.

DFI's emergency guidance can be found here: http://wdfi.org/Apostilles_Notary_Public_and_Trademarks/pdf/Emergency%20Guidance%20-%20Remote%20Notarization.pdf

Additional information from DFI can be found here: https://www.wdfi.org/Apostilles_Notary_Public_and_Trademarks/pdf/Remote%20notarization%20-%20webpage%20announcement.pdf

2019 Wisconsin Act 125 can be found here: https://docs.legis.wisconsin.gov/2019/related/acts/125.pdf ■

FHLB and e-Notary Compliance

Although both the Wisconsin Department of Financial Institutions ("DFI") and the Federal Home Loan Bank of Chicago have been developing eNotary and eNote pledging capability, DFI's emergency action is more helpful in the short term.

DFI issued an emergency guidance authorizing the use of remote online notarization in Wisconsin. DFI approved the use of four online notarization providers. For the notarization of any type of document, DFI has approved the use of Notarize.com and NotaryCam. For real estate transactions, title companies and others performing real estate transaction the use of Pavaso and Nexsys have also been authorized.

Before notaries can perform remote online notarizations, they must complete training from a DFI-approved remote online notarization provider. Then, notaries must use that software platform to perform the remote online notarial acts. Currently, Notarize.com and Pavaso are offering online training opportunities for Wisconsin notaries. Once a notary has completed the approved training provided by a specific provider, the notary is authorized to begin performing remote online notarizations using the provider's platform.

After a notary completes the training and is ready to begin performing remote online notarizations, the provider will notify DFI and DFI will create a list of all Wisconsin notaries authorized to perform remote online notarizations and the platform they are using.

It should be noted that individuals still must comply with the legal requirements for a document that requires notarization. For example, if a document requires additional witnesses to be present at the time of notarization, those additional witnesses must still be present. For land transactions, DFI also cautions that notaries should check with their title companies to ensure that their remote notary provider is approved for insurance purposes.

Additionally, in February 2020, Federal Home Loan Banks ("FHLB") announced that they will begin accepting eNotes as collateral sometime in 2020 and that it has created a policy, entitled "Electronic Promissory Notes (eNotes) Model Collateral Acceptance Requirements and Guidelines," which set out the core requirements for acceptance of eNotes as collateral. To begin, FHLB will only be accepting 1-4 family mortgage loans and closed end term 2nd mortgage loans as eligible eNotes. FHLB will accept eNotes that are created, signed, and stored according to the standards for transferrable records under the Electronic Signatures and Global National Commerce Act.

Before a financial institution can pledge eNotes as collateral to FHLB, the financial institution must execute an addendum to its existing FHLB agreement. To prepare for FHLB's acceptance of eNotes, financial institutions should review FHLB's eNote Requirements and Guidelines Policy, which is available on its website, to ensure that their processes and systems follow FHLB requirements. Financial Institutions should ensure that their eClosing systems meet the requirements established by the FHLB. The eClosing system should allow the eNote to be signed with a tamper evidence signature to verify the integrity of the electronic record. Further, the eClosing system must designate an eNote as the single authoritative copy. Additionally, eClosing system must create a reliable and trustworthy audit trail of the critical events at closing. Finally, the eClosing system's encryption algorithms must be compliant with National Institute of Standards and Technology and FIPS 140-2 guidance.

If a financial institution is not a member of MERS, it will want to become a member of MERS and sign the eRegistry Addendum. Similarly, if the financial institution is already a member of MERS, it will want to ensure that it has signed the eRegistry Addendum.

Additionally, the financial institution should acknowledge FHLB as a secured party in its MERS profile.

Finally, FHLB has reviewed the basic security of many eVault vendor systems. Financial institutions should ensure that their eVaults are compliant with FHLB's requirements and ensure that the eVault undergoes FHLB's review and due diligence process. Financial institutions should also ensure that its eVault provider can connect with the FHLB's eVault and MERS eRegistry. Once approved, the financial institution must store the authoritative copy of the eNote in its eVault until it is pledged and transferred to FHLB's eVault. Financial institutions can review Fannie Mae and Freddie Mac's vendor lists for potential eClosing and eVault providers.

While pledging of eNotes is not currently available, your financial institution can take steps now to be ready when it does become available. We have contacted the Chicago FHLB for the anticipated start date and will let you know when eNote pledging will be available.

WBA wishes to thank Atty. Athena Skaleris, Boardman & Clark, llp for providing this article. ■

MPF Program Policy and Fannie Mae Guidance

During the week of March 16, 2020, both the MPF Program and Fannie Mae announced new policies that allows Servicers to better assist borrowers who have been impacted by COVID-19. Under the MPF Program Policy and the Fannie Mae guidance in Lender Letter LL-2020-02, Servicers are instructed to evaluate borrowers for a forbearance plan in accordance with Chapter 8.7 of the MPF Tradition Service Guide or Fannie Mae's *Servicing Guide* D2-3.2-01, respectively, if the borrowers have experienced hardship as a result of COVID-19 and that hardship has impacted their ability to pay their monthly mortgage payments. The MPF Program Policy and the Fannie Mae Lender Letter state that hardship resulting from COVID-19 includes unemployment, reduction in regular work hours, or illness of the borrower, co-borrower, or a dependent. Before offering a forbearance plan, the Servicer must achieve quality right party right contact (QRPC) with the borrower. **Most importantly, neither the MPF Program nor Fannie Mae require Servicers to verify or obtain documentation of the borrower's hardship.** The MPF Program Policy clarifies that Servicers may not offer relief timeframes that are greater than those provided for in MPF Guides without first receiving prior approval from the MPF Provider. The Fannie Mae Lender Letter advised that when determining the eligibility for a forbearance plan, the property securing the mortgage loan may be a principal residence, a second home, or any investment property.

In evaluating a borrower after the borrower has received a forbearance plan due to COVID-19, both the MPF Program Policy and the Fannie Mae Lender Letter establish that Servicers must begin attempts to contact the borrower no later than 30 days prior to the expiration of the forbearance plan term. Servicers are expected to do this until either QRPC is achieved or the forbearance plan term has expired. In reaching out, Servicers are expected to determine the appropriate workout alternative that best fits the borrower's circumstance and determine whether a loan modification is appropriate. Fannie Mae's Lender Letter provided a table that gives Servicers the requirements under which they should carefully evaluate each case before determining which mortgage loan modification is most appropriate for the borrower. For more details, Servicers can access LL-2020-02 on Fannie Mae's website.

During an active forbearance plan, repayment plan, or Trial Period Plan where the borrower is making the required payments as agreed, even though payments are past due, MPF and Fannie Mae instruct Servicers to suspend reporting the status of a mortgage loan to credit bureaus as long as the borrower's delinquency is due to hardship caused from COVID-19.

The MPF Program Policy and the Fannie Mae Lender Letter also instructed Servicers to suspend all foreclosure sales and evictions for the next 60 days except in situations where the property has been deemed vacant or abandoned. Under the MPF Program Policy, Servicers were further directed to consider waiving late fees for 90 days and provide guidance to borrowers explaining available relief provisions and/or loss mitigation alternatives.

The MPF Program Policy instructed Servicers and PFIs to rely on applicable MPF Guide sections on the delivery and servicing of mortgage loans affected by major disasters included in MPF Selling/Servicing Guides and are encouraged to contact MPF Service Center with questions about applying the provisions to COVID-19 affected borrowers. Fannie Mae's Lender Letter encouraged Servicers to refer borrowers impacted by COVID-19 to its Disaster Response Network at 1-877-542-9723.

Additionally, the financial institution should acknowledge FHLB as a secured party in its MERS profile.

Finally, FHLB has reviewed the basic security of many eVault vendor systems. Financial institutions should ensure that their eVaults are compliant with FHLB's requirements and ensure that the eVault undergoes FHLB's review and due diligence process. Financial institutions should also ensure that its eVault provider can connect with the FHLB's eVault and MERS eRegistry. Once approved, the financial institution must store the authoritative copy of the eNote in its eVault until it is pledged and transferred to FHLB's eVault. Financial institutions can review Fannie Mae and Freddie Mac's vendor lists for potential eClosing and eVault providers.

While pledging of eNotes is not currently available, your financial institution can take steps now to be ready when it does become available. We have contacted the Chicago FHLB for the anticipated start date and will let you know when eNote pledging will be available.

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The MPF Program Policy and the Fannie Mae Lender Letter are effective immediately and will remain in effect until further notice.

MPF's Announcement also stated that MPF Government loans and MPF Government MBS loans must follow the disaster relief policies issued by the applicable Government Agencies and MPF Xtra loans must follow the disaster relief policies issued by Fannie Mae.

The U.S. Department of Agriculture (USDA) Rural Development Division has announced relief measures for Section 502 Single Family Housing Guaranteed Loan Program (SFHGLP) borrowers affected by COVID-19. With this, USDA Rural Development has encouraged loan services to extend forbearance alternatives to borrowers affected by COVID-19. Further, USDA Rural Development has instructed all loan holders to suspend all foreclosure activity until April 30, 2020. This suspension applies to the initiation of new foreclosure actions and to foreclosures already in process. USDA Rural Development has advised loan servicers to fully document their decisions when loss mitigation services are provided.

Similarly, HUD has instituted a 60-day moratorium on foreclosures and evictions for all properties secured by FHA-insured Single Family mortgages. HUD explained that the moratorium applies to the initiation of foreclosures as well as to the completion of foreclosures already in process. Further, HUD extended by 60 days the deadlines of the first legal action and reasonable diligence timelines.

WBA wishes to thank Atty. Athena Skaleris, Boardman & Clark, llp for providing this article. ■

Regulatory Spotlight

Agencies Issue Pandemic Related Guidance.

- The Federal Financial Institutions Examination Council (FFIEC), on behalf of its members, has issued guidance to remind financial institutions that business continuity plans should address the threat of a pandemic outbreak and its potential impact on the delivery of critical financial services. The guidance is an update to the 2007 Interagency Statement on Pandemic Planning as well as the Interagency Advisory on Influenza Pandemic Preparedness issued **03/15/2006** by the Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). The latest guidance identifies actions that financial institutions should take to minimize the potential adverse effect of a pandemic. The guidance may be viewed at: https://www.fdic.gov/news/news/financial/2020/fil20014.html.

- The Board of Governors of the Federal Reserve System (FRB), Consumer Financial Protection Bureau (CFPB), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and Conference of State Bank Supervisors (CSBS) have issued guidance to encourage financial institutions to meet the financial needs of customers and members affected by the coronavirus. The agencies recognize the potential impact of the coronavirus on customers, members, and operations of many financial institutions and will provide appropriate regulatory assistance to affected institutions subject to their supervision. The agencies noted that financial institutions should work constructively with borrowers and other customers in affected communities. Prudent efforts that are consistent with safe and sound lending practices should not be subject to examiner criticism. The agencies further state understanding that many financial institutions may face current staffing and other challenges. In cases in which operational challenges persist, the agencies will expedite, as appropriate, any request to provide more convenient availability of services in affected communities. The agencies also will work with affected financial institutions in scheduling examinations or inspections to minimize disruption and burden. The guidance may be viewed at: https://www.fdic.gov/news/news/press/2020/pr20025.html.

Agencies Issue Final Rules to Adjust CMPs for Inflation.

- The Department of Housing and Urban Development (HUD) has issued a final rule to provide for 2020 inflation adjustments of civil monetary penalty (CMP) amounts required by the Federal Civil Penalties Inflation Adjustment Act, as amended by the Federal Civil Penalties Inflation Adjustment Act Improvements Act. Please see the final rule for the adjusted amounts. The final rule is effective **04/06/2020**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-03-06/pdf/2020-04146.pdf. *Federal Register*, Vol. 85, No. 45, 03/06/2020, 13041-13045.

- The Financial Crimes Enforcement Network (FinCEN) has issued a final rule to reflect inflation adjustments to its civil monetary penalties (CMPs) as mandated by the Federal Civil Penalties Inflation Adjustment Act, as amended by the Federal Civil Penalties

FDIC FAQs for Banker and Consumers

On March 18th, FDIC issued two sets of frequently asked questions (FAQs). One series is aimed to help answer COVID-19 related questions of consumers; the second series of questions are topics related to bank operations and filings. Both FAQs may be found at: https://www.fdic.gov/coronavirus/index.html.

State Agency Statement and Issuances

Wisconsin's DFI has also issued a statement as a result of COVID-19. On March 18th, in connection with Governor Ever's declaration of a health emergency, DFI issued a letter to support and reinforce the FFIEC Pandemic Preparedness Guidance issued March 6, 2020. DFI also stated it recognizes the potential impact of COVID-19 on bank customers and operations. DFI stated it will work with affected financial institutions to provide appropriate regulatory assistance as needed. DFI also instructed banks to inform their DFI Division of Banking supervisor, or call (608) 261-7578, if any changes are made to public access at a financial institution due to COVID-19 concerns.

On March 17, 2020, Wisconsin's DHS issued Emergency Order #5 to prohibit mass gatherings of 10 people or more to slow the spread of COVID-19. An exemption to the order is an office space so long as social distancing is in place. DFI issued a letter to bank executives dated March 18, 2020, stating banks are exempt from the DHS emergency order: https://www.wdfi.org/_resources/indexed/site/fi/banks/20200318_COVID-19_BankLetter_DFI-BankAdministrator_vFINAL.pdf.

Under Wisconsin law, licensed mortgage loan originators can only work from certain locations. To assist with virus mitigation efforts, DFI has issued a directive concerning licensed mortgage loan originators in response to COVID-19. DFI stated in its directive that licensed mortgage loan originators may work from home, whether located in Wisconsin or another state, even if the home is not a licensed or registered office or branch office of the sponsoring mortgage banker, mortgage broker, or registered entity. This action may be permissible if certain criteria are met as outlined on DFI's mortgage banking website: http://www.wdfi.org/fi/mortbank/default.htm.

On March 24, 2020, Governor Evers, through his designee, DHS Secretary Andrea Palm issued Emergency Order #12, "Safer at Home" which became effective at 8 a.m. on Wed, March 25 and ends at 8 a.m. Friday, April 24 (unless superceded sooner). The banking industry is exempt from the order since it is deemed an essential business. This is accomplished in two ways under the order. First, it is a reference to the US. Department of Homeland Security's Cybersecurity and Infrastructure Security Agency (CISA) guidance as to the 16 categories of "Essential Critical Infrastructure Workers during the COVID-19 Response." Second, banks are also separately and specifically identified in Section 13(l) of the most recently issued order. The order may be viewed at: https://evers.wi.gov/Documents/COVID19/EMO12-SaferAtHome.pdf.

Conclusion

Both federal and state banking agencies have issued guidance related to COVID-19 and its impact on financial institutions and their customers. WBA has created a COVID-19 Resources webpage to keep updated, relevant COVID-19 information in a centralized and organized place. The resource page may be viewed at: https://www.wisbank.com/resources/coronavirus-covid-19/.

Wisconsin Department of Financial Institution's Emergency Guidance on Remote Notarization

On March 18, 2020 the Wisconsin Department of Financial Institutions (DFI) issued emergency guidance on remote notarization (guidance). Individuals who need documents notarized remotely may use a DFI-approved remote online notarization provider.

Summary

Generally speaking, a person seeking notarization must "appear" before a notary public and in the "presence" of witnesses. As of publication of this article, DFI has issued guidance that, until further notice, it will construe the terms "appear" and "presence" to include appearances by remote live audio and video connection.

If a bank is seeking to meet “appearance” or “presence” requirements remotely, it is important to understand that any legal requirements governing the validity of a document must still be observed. The only difference is participation in those requirements can be accomplished remotely. For example, if a customer is unable to sign a mortgage in person, they might request to close remotely. In that situation, a bank seeking an acknowledgement of the mortgage (and other closing documents) might consider remote notarization as an option. Specifically, acknowledgement of a mortgage requires the party’s “appearance” in the “presence” of the notarial officer. Those requirements could be met remotely while the guidance remains in effect. Thus, institutions must consider the requirements they are seeking to meet remotely and how they fit within the scope of DFI’s guidance. When considering remote notarization, a bank should also confirm with its title company to ensure the process has been approved for insurance purposes.

Remote Notarization Requirements

DFI has provided a list of DFI-approved remote online notarization providers. Once a bank has determined that it wishes to meet notarization requirements remotely, the next steps can be as simple as reaching out to an approved vendor. DFI has indicated that individuals who need to notarize a document remotely can use Notarize.com and NotaryCam. Title companies and others performing real-estate transactions can also use Pavaso or Nexys, which provide remote online notarization platforms for real-estate transactions. DocVerify also offers remote notarization services for businesses and others. A Wisconsin notary seeking to perform remote online notarizations must get trained on the standards for remote online notarization through one of these appointed technology provides, and use their software platforms to perform online notarial acts.

Banks should again consider the types of documents being notarized and whether its remote notary provider is able to meet those requirements. DFI has acknowledged that the vendors listed above are experienced providers, regulated under standards for remote online notarization that meet or exceed the safeguards set by Wisconsin law. They will also approve providers who meet those standards as well.

Legal and Procedural Considerations

On March 3, 2020 the Governor signed 2019 Wisconsin Act 125 into law (Act 125), which authorizes online notarial acts. Act 125 adopts the Uniform Law Commission’s Revised Uniform Law on Notarial Acts which allows for remote notarization of documents where a person does not appear in person before a notary public.

Act 125 includes the following provisions related to remote notarization:

- Authorizes a notary public located in the state to perform a notarial act using communication technology[1] for a remotely located individual if:
  - The notary public has:
    - personal knowledge of the identity of the individual,
    - satisfactory evidence of the identity of the remotely located individual by oath or affirmation from a credible witness appearing before the notary public, or
    - obtained satisfactory evidence of the identity of the remotely located individual by using at least 2 different types of identity proofing.
  - The notary public is able reasonably to confirm that a record before the notary public is the same record in which the remotely located individual made a statement or on which the individual executed a signature.
  - The notary public, or a person acting on behalf of the notary public, creates an audio-visual recording of the performance of the notarial act.
  - For a remotely located individual located outside the United States, all of the following must be satisfied:
    - The record is to be filed with or relates to a matter before a public official or court, governmental entity, or other entity subject to the jurisdiction of the United States. Or, the record involves property located in the territorial jurisdiction of the United States or involves a transaction substantially connected with the United States.
    - The act of making the statement or signing the record is not prohibited by the foreign state in which the remotely located individual is located.

1 “Communication technology” means an electronic device or process that satisfies all of the following: 1. The device or process allows a notary public and a remotely located individual to communicate with each other simultaneously by sight and sound. 2. When necessary and consistent with other applicable law, the device or process facilitates communication with a remotely located individual who has a vision, hearing, or speech impairment.

- Provides that the authority to remotely notarize a document does not apply to a transaction that is governed by a law related to any of the following:
  - Wills, codicils, or testamentary trusts.
  - Living trusts or trust amendments for personal use.
  - Powers of attorney.
  - Marital property agreements.
  - Powers of attorney for health care, declarations to physicians (living wills), and authorizations for use and disclosure of protected health care information.

- Creates a remote notary council that is attached to DFI and is required to adopt standards to implement the provisions of the Act related to remote notarization. Membership of the remote notary council is comprised of the DFI secretary or the secretary's designee and one member representing each of the following for three-year terms:
  - An association of title insurance companies.
  - Attorneys who practice real estate law.
  - An association of bankers.
  - Providers of communication technology used to perform a notarial act involving a remotely located individual.

Act 125 also requires DFI to do the following:

- Maintain an electronic database of notaries public for which:
  - A person may verify the authority of a notary public to perform notarial acts, and
  - Indicates whether a notary public has informed DFI that the notary public will be performing notarial acts for remotely located individuals.

- Promulgate rules that do all of the following:
  - Establish maximum fees that may be charged by a notary public for performing a notarial act for a remotely located individual.
  - Prescribe the manner of performing notarial acts regarding tangible and electronic records.
  - Include provisions to ensure that any change to or tampering with a record bearing a certificate of a notarial act is self-evident.
  - Include provisions to ensure integrity in the creation, transmittal, storage, or authentication of electronic records or signatures.
  - Prescribe the process of granting, renewing, conditioning, denying, suspending, or revoking a notary public commission and assuring the trustworthiness of an individual holding a commission as a notary public.
  - Include provisions to prevent fraud or mistake in the performance of notarial acts.

- In promulgating the rules described above, consider all of the following:
  - The most recent standards regarding electronic records promulgated by national bodies, such as the National Association of Secretaries of State;
  - The standards, practices, and customs of other jurisdictions that substantially enact the RULONA 2018 or any subsequent version of it; and
  - The views of governmental officials, entities, and other interested persons.

- Promulgate the rules listed above as emergency rules without making the findings generally required for emergency rulemaking. DFI is also not required to prepare a scope statement of the emergency rules or present the emergency rules to the governor for approval.

- Authorizes DFI to investigate violations of state law related to notarial acts and revoke, suspend, or restrict any notarial commission or registration if the person holding the commission or registration has refused to comply with an investigation demand for production of any record that DFI considers relevant or material to the investigation. DFI is also authorized to revoke, suspend, or restrict any notarial commission or registration if the person holding the commission or registration has violated, is violating, or is able to violate state law related to notarial acts.

Conclusion

While Act 125 provides standards for remote notarization, it requires implementation by rulemaking by DFI. DFI's emergency guidance on remote notarization permits operation under the standards while the guidance remains in effect.

DFI's emergency guidance can be found here: http://wdfi.org/Apostilles_Notary_Public_and_Trademarks/pdf/Emergency%20Guidance%20-%20Remote%20Notarization.pdf

Additional information from DFI can be found here: https://www.wdfi.org/Apostilles_Notary_Public_and_Trademarks/pdf/Remote%20notarization%20-%20webpage%20announcement.pdf

2019 Wisconsin Act 125 can be found here: https://docs.legis.wisconsin.gov/2019/related/acts/125.pdf ■

FHLB and e-Notary Compliance

Although both the Wisconsin Department of Financial Institutions ("DFI") and the Federal Home Loan Bank of Chicago have been developing eNotary and eNote pledging capability, DFI's emergency action is more helpful in the short term.

DFI issued an emergency guidance authorizing the use of remote online notarization in Wisconsin. DFI approved the use of four online notarization providers. For the notarization of any type of document, DFI has approved the use of Notarize.com and NotaryCam. For real estate transactions, title companies and others performing real estate transaction the use of Pavaso and Nexsys have also been authorized.

Before notaries can perform remote online notarizations, they must complete training from a DFI-approved remote online notarization provider. Then, notaries must use that software platform to perform the remote online notarial acts. Currently, Notarize.com and Pavaso are offering online training opportunities for Wisconsin notaries. Once a notary has completed the approved training provided by a specific provider, the notary is authorized to begin performing remote online notarizations using the provider's platform.

After a notary completes the training and is ready to begin performing remote online notarizations, the provider will notify DFI and DFI will create a list of all Wisconsin notaries authorized to perform remote online notarizations and the platform they are using.

It should be noted that individuals still must comply with the legal requirements for a document that requires notarization. For example, if a document requires additional witnesses to be present at the time of notarization, those additional witnesses must still be present. For land transactions, DFI also cautions that notaries should check with their title companies to ensure that their remote notary provider is approved for insurance purposes.

Additionally, in February 2020, Federal Home Loan Banks ("FHLB") announced that they will begin accepting eNotes as collateral sometime in 2020 and that it has created a policy, entitled "Electronic Promissory Notes (eNotes) Model Collateral Acceptance Requirements and Guidelines," which set out the core requirements for acceptance of eNotes as collateral. To begin, FHLB will only be accepting 1-4 family mortgage loans and closed end term 2nd mortgage loans as eligible eNotes. FHLB will accept eNotes that are created, signed, and stored according to the standards for transferrable records under the Electronic Signatures and Global National Commerce Act.

Before a financial institution can pledge eNotes as collateral to FHLB, the financial institution must execute an addendum to its existing FHLB agreement. To prepare for FHLB's acceptance of eNotes, financial institutions should review FHLB's eNote Requirements and Guidelines Policy, which is available on its website, to ensure that their processes and systems follow FHLB requirements. Financial Institutions should ensure that their eClosing systems meet the requirements established by the FHLB. The eClosing system should allow the eNote to be signed with a tamper evidence signature to verify the integrity of the electronic record. Further, the eClosing system must designate an eNote as the single authoritative copy. Additionally, eClosing system must create a reliable and trustworthy audit trail of the critical events at closing. Finally, the eClosing system's encryption algorithms must be compliant with National Institute of Standards and Technology and FIPS 140-2 guidance.

If a financial institution is not a member of MERS, it will want to become a member of MERS and sign the eRegistry Addendum. Similarly, if the financial institution is already a member of MERS, it will want to ensure that it has signed the eRegistry Addendum.

The agencies expect that supervisory feedback for institutions will be focused on identifying issues, correcting deficiencies, and ensuring appropriate remediation to consumers. The agencies do not expect to take a consumer compliance public enforcement action against an institution, provided that the circumstances were related to the National Emergency and that the institution made good faith efforts to support borrowers and comply with the consumer protection requirements, as well as responded to any needed corrective action.

Financial institutions looking to work with their customers must not only consider the above, but also what is appropriate based upon their own size, customer base, lines of business, and the unique situations faced by their borrowers. There are generally no "one-size-fits-all" answers and considerations must often be made on a case-by-case basis. That said, some more generalized considerations a financial institution might make are as follows:

- Which customers, and what situations, the financial institution is willing and able to accommodate;
- How will the financial institution address the situations it has decided it is willing and able to accommodate;
- What are the impacts to the financial institution in making accommodations;
- What forms does the financial institution have to document the accommodation;
- How long should the financial institution make the accommodation;
- How will the financial institution communicate with borrowers regarding the financial institution's efforts and options;
- How will the financial institution track all efforts and follow-up with borrowers;
- How will accommodations affect loan operating systems, such as automatic late payment notices, automatic late-fee assessments, automatic payment allocations, automatic reporting to credit bureaus, and others; and
- The Wisconsin Consumer Act limitations on charging deferral fees.

Conclusion

The April 7 guidance encourages financial institutions to work with customers affected by the pandemic, but all loan modifications should comply with applicable laws and regulations and be consistent with safe and sound practices. Financial institutions are reminded to consider what is appropriate for their institution pursuant to policy, procedure, and sound banking practices in addition to the above guidance. ■

Appraisal Relief Amidst COVID-19

On April 14, 2020, the Bureau of Consumer Financial Protection (CFPB), Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and National Credit Union Administration (NCUA) (collectively, the agencies), in consultation with the state financial regulators, issued an interagency statement to address challenges relating to appraisals and evaluations for real estate-related financial transactions affected by the Coronavirus Disease 2019 (COVID-19). The statement outlines existing flexibilities in appraisal-industry standards and in applicable banking regulations. The agencies also issued an interim rule to revise appraisal requirements to help relieve compliance-related complications due to business interruptions caused by COVID-19. The following is a recap of the interagency statement and interim final rule.

Interagency Appraisal Statement

The interagency statement outlines the flexibilities available for physical property inspections, for residential properties underwritten to Fannie Mae- and Freddie Mac-standards, and through use of existing exceptions in bank appraisal regulations.

Flexibility for Physical Property Inspections:

The agencies' appraisal regulations require appraisals be conducted in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP); and, while exterior and interior inspections are commonly conducted when preparing appraisals and evaluations, such inspections are not required by the agencies' appraisal regulations which implement Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). Rather, as allowed by USPAP, the agencies confirm that an appraiser can determine the characteristics of a property through, among other things, any combination of property inspection, asset records, photographs, property sketches, and recorded media.

Further, the agencies mention that bank management should also be aware that the Appraisal Standards Board's "2020-21 USPAP Q&A" issued March 17, 2020, indicates that when an interior inspection would customarily be part of the scope of work, a health or other emergency condition may require an appraiser to make an extraordinary assumption about the interior of a property. USPAP permits this approach when the appraiser has a reasonable basis for the extraordinary assumption and as long as its use still results in a credible analysis. Both desktop appraisals and exterior-only appraisals can fulfill the requirements of USPAP if the analysis is credible. The agencies caution, however, that interior inspections are still required for certain higher-priced mortgage loans (HPMLs).

Flexibility for Fannie Mae and Freddie Mac Underwritten Loans:

The interagency statement also describes flexibility for appraisals of residential properties that are underwritten to Fannie Mae and Freddie Mac standards. Fannie and Freddie have recently issued guidance providing temporary flexibility in appraisal standards for loans that they purchase, including allowing exterior-only and desktop appraisals for certain loans. Specifically, their guidance states that:

- For certain qualifying principal or primary residence loans, desktop appraisals and exterior-only appraisals are now acceptable. For Freddie Mac, qualifying primary residence loans are those with up to 97 percent loan-to-value (LTV). For Fannie Mae, qualifying primary residence loans are those with an LTV within the range listed on Fannie's current eligibility matrix.
- For second homes and investment properties with 85 percent or less LTV, desktop appraisals and exterior-only appraisals are now acceptable.
- For limited cash-out refinances where the mortgage being refinanced is owned by Fannie and Freddie and the LTV is within the currently acceptable range, exterior-only appraisals are now acceptable.

In addition, lenders may sell eligible loans without an appraisal under the appraisal waiver programs provided by Fannie and Freddie. For Freddie Mac, the appraisal waiver program for lenders has been expanded to include certain refinancing activity, including both cash-out refinances and no cash-out refinances. Fannie Mae also allows lenders to waive the appraisal requirement for some refinance transactions.

Existing Exceptions in Appraisal Regulations:

Through the interagency statement, OCC, FRB, and FDIC remind their supervised institutions that current appraisal regulations provide at least fourteen exceptions to the requirement for an appraisal by a certified or licensed appraiser. The agencies believe the following exceptions to be the most useful for real estate financial transactions during the COVID-19 emergency:

- A residential real estate transaction with a transaction value of $400,000 or less;
- A commercial real estate transaction with a transaction value of $500,000 or less;
- A business loan that has a transaction value of $1 million or less where the loan does not depend on the sale of, or rental income derived from, real estate as the primary source of repayment;
- The transaction involves an existing extension of credit at the lending institution, provided that:
  - ◊ There has been no obvious and material change in market conditions or physical aspects of the property that threatens the adequacy of the institution's real estate collateral protection after the transaction, even with the advancement of new monies; or
  - ◊ There is no advancement of new monies, other than funds necessary to cover reasonable closing costs;
- The transaction is wholly or partially insured or guaranteed by a U.S. government agency or U.S. government sponsored agency;
- The transaction either:
  - ◊ Qualifies for sale to a U.S. government agency or government sponsored agency; or
  - ◊ Involves a residential real estate transaction where the appraisal conforms to the Fannie Mae or Freddie Mac appraisal standards.

The agencies provide numerous resources throughout the interagency statement including: each agency's appraisal regulation citation, USPAP advisory opinion references, and links to Fannie Mae and Freddie Mac Selling Guidance. The interagency statement may be viewed by clicking here.

Appraisal Interim Final Rule

On April 17, 2020, the OCC, FRB, and FDIC (collectively, the agencies) published in the *Federal Register* an interim final rule to amend the agencies' regulations that require appraisals of real estate for certain transactions to help provide regulatory relief to allow regulated institutions to expeditiously extend liquidity to creditworthy households and businesses in light of recent strains on the economy as a result of COVID-19.

Special Focus

The interim final rule defers the requirement to obtain an appraisal or evaluation for up to 120 days following the closing of a transaction for certain residential and commercial real estate transactions, excluding transactions for acquisition, development, and construction of real estate. The agencies excluded transactions for acquisition, development, and construction of real estate because the agencies believe the loans present heightened risks not associated with financing existing real estate. Additionally, the transactions are excluded because repayment of those transactions is generally dependent on the completion or sale of the property being held as collateral as opposed to repayment generated by existing collateral or the borrower.

Under the interim final rule, regulated institutions may close a real estate loan without a contemporaneous appraisal or evaluation, subject to a requirement that institutions obtain the appraisal or evaluation, as would have been required under the appraisal regulations without the deferral, within a grace period of 120 days after closing of the transaction. While appraisals and evaluations can be deferred, the agencies expect institutions to use best efforts and available information to develop a well-informed estimate of the collateral value of the subject property.

For purposes of risk-weighting of residential mortgage exposures, the agencies have stated that an institution's prudent underwriting estimation of the collateral value of the subject property will be considered to meet the agencies' appraisal and evaluation requirements during the deferral period. No specific underwriting estimation tool is identified in the interim final rule. In addition, the agencies will continue to expect regulated institutions to adhere to internal underwriting standards for assessing borrowers' creditworthiness and repayment capacity, and to develop procedures for estimating the collateral's value for the purposes of extending or refinancing credit. No specific procedure is identified in the interim final rule for estimating collateral value.

The agencies also expect institutions to develop an appropriate risk mitigation strategy if the appraisal or evaluation ultimately reveals a market value significantly lower than the expected market value. An institution's risk mitigation strategy should consider safety and soundness risk to the institution, balanced with mitigation of financial harm to COVID-19-affected borrowers.

The interim final rule is effective April 17, 2020 through December 31, 2020 (a transaction closed on or before December 31, 2020 is eligible for a deferral). Comments on the interim final rule are due June 1, 2020. The interim final rule may be viewed by clicking here. ■

Regulatory Spotlight

Agencies Issue Interim Final Capital Rule to Revise Eligible Retained Income Definition.

The Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) issued an interim final rule regarding regulatory capital. In light of recent disruptions in economic conditions caused by COVID-19 and current strains in U.S. financial markets, the agencies issued the interim final rule to revise the definition of "eligible retained income" for all depository institutions, bank holding companies, and savings and loan holding companies subject to the agencies' capital rule. The revised definition will make any automatic limitations on capital distributions that could apply under the agencies' capital rules more gradual. The interim final rule is effective **03/20/2020**. Comments are due **05/04/2020**. The interim final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-03-20/pdf/2020-06051.pdf. *Federal Register*, Vol. 85, No. 55, 03/20/2020, 15909-15916.

Agencies Issue Interim Final Rule to Establish Money Market Mutual Fund Liquidity Facility.

The Board of Governors of the Federal Reserve System (FRB), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) (collective, the agencies) seek comment on an interim final rule regarding the Money Market Mutual Fund Liquidity Facility (MMMLF). To provide liquidity to the money market sector to help stabilize the financial system, FRB authorized the Federal Reserve Bank of Boston to establish the MMMLF, pursuant to section 13(3) of the Federal Reserve Act. Under MMMLF, the Federal Reserve Bank of Boston will extend non-recourse loans to eligible financial institutions to purchase certain types of assets from money market mutual funds. To facilitate the FRB lending program, the agencies have adopted the interim final rule to allow banking organizations to neutralize the regulatory capital effects of participating in the program. The treatment would extend to the community bank leverage ratio. The interim final rule is effective **03/23/2020**. Comments are due **05/07/2020**. The interim final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-03-23/pdf/2020-06156.pdf. *Federal Register*, Vol. 85, No. 56, 03/23/2020, 16232-16237.

Pandemic-Related Loan Modifications

The pandemic continues to present an ever-changing situation, presenting unique issues for both banks and their customers to work through. Particularly, for those customers experiencing financial hardship. As banks work to help their customers face these challenges through deferrals, modifications, and other work-outs, compliance questions often arise. The Federal and State banking agencies have issued statements and guidance acknowledging the disruptions and have provided some insight into how banks can work with their customers while still meeting ongoing regulatory requirements. This article presents that guidance for loan modifications, accounting and reporting for troubled debt restructurings, and working with customers.

Federal Agency Guidance

The Federal banking agencies have issued two statements on loan modifications for financial institutions with customers affected by the Coronavirus. The first statement, issued on March 22, 2020, encourages financial institutions to work prudently with borrowers and describes the agencies' interpretation of how current accounting rules under U.S. General Accepted Accounting Principles (GAAP) apply to certain COVID-19-related modifications. The agencies have indicated that they will not criticize institutions for working with borrowers when mitigating credit risk through prudent actions consistent with safe and sound practices.

Subsequent to the March 22 guidance, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act, or Act) was enacted. The CARES Act provides financial institutions the option to temporarily suspend certain U.S. GAAP requirements related to troubled debt restructurings (TDR) for a limited period of time to account for the effects of COVID-19. The agencies have since issued a revised interagency statement on April 7, 2020 (April guidance) clarifying the interaction between the March 22, 2020, interagency statement and section 4013 of the CARES Act, Temporary Relief from Troubled Debt Restructurings (section 4013), as well as the agencies' views on consumer protection considerations.

General Guidance

The April guidance again encourages financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. The guidance reiterates that the agencies will not criticize financial institutions that mitigate credit risk through prudent actions consistent with safe and sound practices. The agencies consider such proactive measures to be in the best interest of institutions, their borrowers, and the economy. The guidance provides that financial institutions have broad discretion to implement prudent modification programs consistent with the framework included in the statement. As described below, institutions generally do not need to categorize COVID-19-related modifications as TDRs, and the agencies will not direct supervised institutions to automatically categorize all COVID-19 related loan modifications as TDRs.

Accounting and Reporting

The Financial Accounting Standards Board's (FASB's) Accounting Standards Codification (ASC) Topic 310 provides the basis for identifying TDRs and treating TDRs as impaired loans. Specifically, ASC Subtopic 310-40 addresses receivables that are TDRs from a lending institution's standpoint. The CARES Act provides that an insured depository institution that modifies a covered loan in relation to COVID-19-related difficulties in a TDR on or after March 13, 2020, shall not be required to comply with the ASC Subtopic 310-40 for purposes of compliance with the requirements of the Federal Deposit Insurance Act, until such time and under such circumstances as the agencies determine appropriate.

The April guidance provides that a financial institution may account for an eligible loan modification either under section 4013 of the CARES Act or in accordance with ASC Subtopic 310-40.5. To be an eligible loan under section 4013 (section 4013 loan), and accounted for under the Act, a loan modification must be:

- Related to COVID-19;
- Executed on a loan that was not more than 30 days past due as of December 31, 2019; and
- Executed between March 1, 2020, and the earlier of
  - ◊ 60 days after the date of termination of the National Emergency, or
  - ◊ December 31, 2020 (applicable period).

As discussed above, financial institutions accounting for eligible loans under section 4013 are not required to apply ASC Subtopic 310-40 to the section 4013 loans for the term of the loan modification. In addition, financial institutions do not have to report section 4013 loans as TDRs in regulatory reports. However, the Act requires financial institutions to maintain records of the volume of loans involved and the agencies emphasize this fact in their April guidance. The April guidance also provides that institutions do not need to determine impairment associated with certain loan concessions that would otherwise have been required for TDRs (e.g., interest rate concessions, payment deferrals, or loan extensions).

The April guidance affirms that modifications of loan terms do not automatically result in TDRs. According to ASC Subtopic 310-40, a restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies state in the April guidance that they have confirmed with FASB staff that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not TDRs under ASC Subtopic 310-40. This includes short-term (e.g., six months) modifications such as payment deferrals, fee waivers, extensions of repayment terms, or delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented. Accordingly, working with borrowers who are current on existing loans, either individually or as part of a program for creditworthy borrowers who are experiencing short-term financial or operational problems as a result of COVID-19 generally would not be considered TDRs.

More specifically, financial institutions may presume that borrowers are not experiencing financial difficulties at the time of the modification for purposes of determining TDR status, and thus no further TDR analysis is required for each loan modification in the program, if:

- The modification is in response to the National Emergency;
- The borrower was current on payments at the time the modification program is implemented; and
- The modification is short-term (e.g., six months).

Additional Guidance

In addition to the accounting considerations, the agencies have provided other, related clarifications in the April 7 guidance. Specifically, the April 7 guidance provides that:

- Examiners will exercise judgment in reviewing loan modifications and will not automatically adversely risk rate credits that are affected by COVID-19.
- Efforts to work with borrowers of one-to-four family residential mortgages, where the loans are prudently underwritten, and not 90 days or more past due or carried in nonaccrual status, will not result in the loans being considered restructured or modified for the purposes of their respective risk-based capital rules.
- With regard to loans not otherwise reportable as past due, financial institutions are not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral.
- Short-term arrangements (similar to as discussed above) generally should not be reported as nonaccrual. Institutions should still generally refer to Consolidated Reports of Condition and Income for charge-off status guidance.
- Institutions are reminded that loans that have been restructured as described under this statement will generally continue to be eligible as collateral at the FRB's discount window based on the usual criteria.

Consumer Protection Considerations

The April 7 guidance encourages financial institutions to consider prudent arrangements that can ease cash flow pressures on affected borrowers, improve their capacity to service debt, increase the potential for financially stressed residential borrowers to keep their homes, and facilitate the financial institution's ability to collect on its loans.

When working with borrowers, lenders and servicers should adhere to consumer protection requirements, including fair lending laws, to provide the opportunity for all borrowers to benefit from these arrangements. When exercising supervisory and enforcement responsibilities, the agencies will take into account the unique circumstances impacting borrowers and institutions resulting from the National Emergency. The agencies will take into account an institution's good-faith efforts demonstrably designed to support consumers and comply with consumer protection laws.

The agencies expect that supervisory feedback for institutions will be focused on identifying issues, correcting deficiencies, and ensuring appropriate remediation to consumers. The agencies do not expect to take a consumer compliance public enforcement action against an institution, provided that the circumstances were related to the National Emergency and that the institution made good faith efforts to support borrowers and comply with the consumer protection requirements, as well as responded to any needed corrective action.

Financial institutions looking to work with their customers must not only consider the above, but also what is appropriate based upon their own size, customer base, lines of business, and the unique situations faced by their borrowers. There are generally no "one-size-fits-all" answers and considerations must often be made on a case-by-case basis. That said, some more generalized considerations a financial institution might make are as follows:

- Which customers, and what situations, the financial institution is willing and able to accommodate;
- How will the financial institution address the situations it has decided it is willing and able to accommodate;
- What are the impacts to the financial institution in making accommodations;
- What forms does the financial institution have to document the accommodation;
- How long should the financial institution make the accommodation;
- How will the financial institution communicate with borrowers regarding the financial institution's efforts and options;
- How will the financial institution track all efforts and follow-up with borrowers;
- How will accommodations affect loan operating systems, such as automatic late payment notices, automatic late-fee assessments, automatic payment allocations, automatic reporting to credit bureaus, and others; and
- The Wisconsin Consumer Act limitations on charging deferral fees.

Conclusion

The April 7 guidance encourages financial institutions to work with customers affected by the pandemic, but all loan modifications should comply with applicable laws and regulations and be consistent with safe and sound practices. Financial institutions are reminded to consider what is appropriate for their institution pursuant to policy, procedure, and sound banking practices in addition to the above guidance. ■

Appraisal Relief Amidst COVID-19

On April 14, 2020, the Bureau of Consumer Financial Protection (CFPB), Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and National Credit Union Administration (NCUA) (collectively, the agencies), in consultation with the state financial regulators, issued an interagency statement to address challenges relating to appraisals and evaluations for real estate-related financial transactions affected by the Coronavirus Disease 2019 (COVID-19). The statement outlines existing flexibilities in appraisal-industry standards and in applicable banking regulations. The agencies also issued an interim rule to revise appraisal requirements to help relieve compliance-related complications due to business interruptions caused by COVID-19. The following is a recap of the interagency statement and interim final rule.

Interagency Appraisal Statement

The interagency statement outlines the flexibilities available for physical property inspections, for residential properties underwritten to Fannie Mae- and Freddie Mac-standards, and through use of existing exceptions in bank appraisal regulations.

Flexibility for Physical Property Inspections:

The agencies' appraisal regulations require appraisals be conducted in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP); and, while exterior and interior inspections are commonly conducted when preparing appraisals and evaluations, such inspections are not required by the agencies' appraisal regulations which implement Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). Rather, as allowed by USPAP, the agencies confirm that an appraiser can determine the characteristics of a property through, among other things, any combination of property inspection, asset records, photographs, property sketches, and recorded media.

Further, the agencies mention that bank management should also be aware that the Appraisal Standards Board's "2020-21 USPAP Q&A" issued March 17, 2020, indicates that when an interior inspection would customarily be part of the scope of work, a health or

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Special Focus

What Banks Need to Know About Economic Impact Payments

An aspect of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) includes economic impact payments (EIPs) to be paid to most individuals. Payment processing began as early as April 6, 2020 and at time of this article's publication the EIP program is in full effect, as administered by the Department of the Treasury (Treasury) and Internal Revenue Service (IRS). This article will discuss various aspects of EIPs to assist banks processing these payments and answering customer questions.

Form of Payment

In most instances, an EIP will appear as a standard tax refund direct deposit payment through ACH. The IRS is committed to processing as many payments electronically as possible, but in instances where this is not possible, checks will be issued as well and are discussed below. For individuals who file taxes, IRS will send the payments using the direct deposit information provided in 2018 or 2019 returns. For 2019 filers, that information cannot be changed. 2018 filers may change their direct deposit information electronically.

For individuals who are not required to file taxes and did not and will not file, IRS will still attempt to process the EIP electronically. In these cases, IRS will process EIP based upon information it may have from benefit payments such as Social Security retirement, disability (SSDI), survivor benefits, Supplemental Security Income, or Railroad Retirement and Survivor Benefits. In these cases, the direct deposit will appear as an ACH similar to the benefit payment.

For those eligible for an EIP who are not automatically paid through their tax return, benefit payment, or other means, IRS has prepared a form, available electronically online, to provide payment info. The form will direct the user to create an account, where the user will be able to provide and verify information (including name, driver's license, social security number, bank account number, type, and routing number) which IRS will use to process the EIP.

In some cases, EIPs will be issued by check. The first check file came from the IRS on April 16, and the postal service began picking up payments on April 18, with a pay day of April 22. The postal service will continue to pick them up daily until all are in the mail. Checks have begun arriving for delivery as of April 20 and are expected to continue to arrive at least twice a day. The checks will use the same Treasury tax stock as tax refund checks. EIP checks will have specific identification in the bottom left, stating "economic impact payment" on the first line and will contain the president's name on second line. These checks will also be signed by a fiscal service disbursing official.

Treasury has encouraged banks to work with their customers in helping them to understand the information IRS needs to deliver their EIP. Banks may want to consider working proactively with their customers to direct them to IRS' webpage which walks through the above, and provides FAQs. Additionally, not all customers may be familiar with their account number or bank's routing number and should be reminded where to find these. Customers will likely have further questions about how to get their payment, when it is coming, or why it has not appeared yet.

Considerations for Banks

One of the most frequently asked questions regarding EIPs is whether they are subject to garnishment or offset. Generally speaking, the CARES Act does not exempt EIPs from garnishment whereby a third-party creditor seeks, through legal process, to collect funds owed to them. Thus, if a bank receives a legal process item such as a garnishment order it is required by law to comply with, the EIP amount would not be exempt.

However, EIPs cannot be intercepted by the government for any tax debts. The only exception is for child support. Meaning, delinquent payments collected through the Treasury Offset Program (where tax refunds, for example, would be automatically collected) apply to EIP only for delinquent child support payments. As a result, banks may see EIPs arrive in odd amounts, depending on the amount of child support that may have been offset by Treasury.

Banks have also asked whether funds from an EIP can be used to offset balances due to the bank. The CARES Act does not exempt payments from that type of collection. However, banks should review their policies and consider potential reputational harm before deciding to pursue debt collection in this manner. As with all matters involving offset, WBA recommends considering consultation with bank's legal counsel as well.

Banks have also already begun seeing situations where an EIP is received unexpectedly. For example, a payment to a deceased individual or a joint EIP to a divorced individual. At time of this article's publication, it is WBA's understanding that banks are to process valid payments received in accordance with the payment instructions, similar to the tax refund process. Note that if the account is closed, that procedure means the payment should be rejected. Banks are also reminded that Treasury has no authority to mandate compensation from the bank so long as the payment was posted properly based upon the account number.

To that extent, banks must be prepared for these scenarios, with procedures in place. Bank will want to document the payment order and confirm that the payment is valid, for example, by matching the account to the social security number in the payment order. The procedure under 31 CFR part 210 provides that if bank becomes aware it has received a payment for a payee whose name does not match the payee information, bank must notify IRS. Treasury has recommended that, given the challenges that IRS is facing, banks send a notice of change which would satisfy that requirement.

In addition to the above procedures, banks should be prepared for how they will handle paper checks. As discussed above, some EIPs will be sent by check, and may have already arrived at time of this article's publication. Banks will want to review their existing policies and risk management systems for paper checks and consider whether they should be updated for incoming EIPs. For example, banks should consider whether they have accomodations for and will permit remote deposit capture or ATM deposit, what fraud protection and other security features are in place, and whether they will cash EIP paper checks for non-customers. These are ultimately business and customer experience considerations that each bank must determine individually.

Banks should also familiarize themselves with the Treasury check stock, including not only the EIP aspects above, but additional security features such as microprinting, watermarks, etc. These security features can be reviewed through the Treasury Check Information Verification System which includes a Treasury Check Verification Application. This application is a tool that provides data to help banks make a decision on whether check is valid or not.

Conclusion

Banks have likely already received EIPs through direct deposit and checks will be arriving soon if they have not already. EIPs will continue to be processed as IRS distributes payments through the means discussed above, and customers provide the required information. Banks are again encouraged to share the tools such as the IRS FAQs and portal with their customers in addition to making the operational considerations presented in this article.

The IRS portal can be found by clicking here.

The Treasury Check Verification System can be found by clicking here.

More information about the Treasury Offset Program can be found by clicking here. ■

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Flood Insurance Requirements During the COVID-19 Emergency

On March 9, 2020, the federal financial institution agencies (agencies) issued a joint press release to encourage financial institutions to meet the financial needs of customers affected by the coronavirus (COVID-19 emergency). Since then, the agencies have issued additional guidance, clarification, and in some instances, relief, to aid financial institutions to better assist their customers and continue to meet regulatory requirements.

Many financial institutions currently offer deferral or modification agreements to borrowers experiencing financial hardship caused by the COVID-19 emergency. Such arrangements may trigger the rules governing loans in areas having special flood hazards. This article covers the resources provided by the agencies, which discuss how financial institutions can help borrowers affected by the COVID-19 emergency and continue to meet the flood insurance requirements.

General Requirements

The Flood Disaster Protection Act (FDPA), as implemented by the agencies' rulemaking, requires that each time a financial institution makes, increases, extends, or renews (MIRE event) a loan it must determine whether the property is in a special flood hazard area (SFHA). Flood insurance is generally required for the term of the loan for buildings or mobile homes when in a SFHA. If, at any time during the life of the loan, flood insurance is deficient, the financial institution must initiate force placement procedures.

Over the past months, many financial institutions have worked with struggling borrowers affected by the COVID-19 emergency by offering various forms of modifications, extensions, and deferral agreements. When these agreements trigger a MIRE event, such as by extending the loan term, then flood insurance requirements apply. For example, if a financial institution offers aid to an affected borrower by deferring payments and extending their loan's maturity, this action "extends" the loan and results in a MIRE event. Such agreements could thus trigger requirements such as establishing escrow for flood insurance payments and fees, making a flood zone determination on the property securing the loan, or providing the notice of special flood hazards to the borrower. The FDPA and the agencies' implementing regulations do not provide for a waiver of these requirements in emergency situations. However, the Board of Governors of the Federal Reserve (FRB) and the Federal Deposit Insurance Corporation (FDIC) have issued guidance regarding flood requirements, to help banks meet the needs of their borrowers.

Agency Guidance

FRB has stated that when exercising supervisory and enforcement responsibilities, it will take into account the unique circumstances impacting borrowers and institutions resulting from the COVID-19 emergency. Financial institutions should make good-faith efforts demonstrably designed to support consumers and comply with the flood insurance requirements. In addition, supervisory feedback for institutions will be focused on identifying issues, correcting deficiencies, and ensuring appropriate remediation to consumers. FRB does not expect to take a public enforcement action against an institution, provided that the circumstances were related to the COVID-19 emergency and that the institution made good faith efforts to support borrowers and comply with the flood insurance requirements, as well as responded to any needed corrective action.

FDIC has acknowledged that as financial institutions work to accommodate borrowers during the COVID-19 emergency, meeting flood requirements could pose challenges for lenders and delay relief for borrowers in need. Therefore, FDIC has stated that when working with borrowers impacted by the COVID-19 emergency triggers a MIRE event, lenders may, if applicable:

- Rely temporarily on a loan's previous flood hazard determination on file rather than obtain a new one during the COVID-19 emergency;

- Delay the establishment of escrow accounts for applicable loans until after the COVID-19 emergency; and

- Delay providing a written flood notice to a borrower until after the COVID-19 emergency if a property is located in a Special Flood Hazard Area (SFHA) and informing consumers about the availability for special disaster relief assistance in the event of a flood. Prior to providing written notice, the lender may, at its discretion, choose to use another method to inform the borrower of this information (e.g. by email or telephone).

FDIC has stated that lenders should have a system in place to ensure deferred flood insurance requirements are addressed as soon as reasonably practicable. FDIC examiners, under the FDIC's discretionary examination authority, will not criticize lenders' good faith flood insurance compliance efforts to accommodate borrowers in a safe and sound manner during the COVID-19 emergency.

National Flood Insurance Program Renewal

On March 28, 2020, the Federal Emergency Management Agency (FEMA) issued Bulletin W-20002 (Bulletin) to extend the grace period to renew the National Flood Insurance Program (NFIP) policies that expire between February 13, 2020 and June 15, 2020 from 30 days to 120 days. Thus, a borrower will be covered by the NFIP policy if the flood insurance premium is paid before the 120-day grace period expires.

As discussed above, the FDPA provides requirements and procedures for the force placement of flood insurance when a designated loan is not covered by a sufficient amount of flood insurance. The rules require that under force placement procedures, the lender must notify the borrower when adequate flood insurance is not in place. If the borrower does not provide evidence of sufficient coverage within 45 days after notification, the lender must force place flood insurance in an amount that will satisfy the regulatory requirements. However, in light of the Bulletin, FRB has stated that for NFIP policies expiring during the FEMA emergency period:

- A lender may provide the required notice to the borrower after determining the policy has expired with an indication that the NFIP grace period has been extended for 120 days. Lenders may inform borrowers that, in light of the Bulletin, force placement will not occur until after the end of the 120-day period.

- Alternatively, a lender may provide the required notice to the borrower at least 45 days before the end of the 120-day grace period.

- For either alternative, the lender must force place flood insurance on the borrower's behalf if the borrower does not pay the premium by the end of the 120-day grace period.

- As discussed above, FRB does not expect to take supervisory or enforcement action against the lender for violating the flood insurance force placement requirements, provided that the circumstances were related to COVID-19, and that the lender has made good-faith efforts to support borrowers and comply with the flood insurance requirements, as well as responded to any needed corrective action.

- Lenders should be aware that if they force place flood insurance for NFIP policies that expire during the FEMA emergency period prior to the expiration of the 120-day grace period and the borrower pays the premium by the end of the 120-day grace period, consistent with the flood insurance regulatory requirements, the lender would be required to refund the borrower for any overlapping flood insurance coverage.

Conclusion

The flood rules have not been waived. However, FRB and FDIC have encouraged financial institutions to assist customers affected by the COVID-19 emergency. In order to better assist financial institutions accomplish those goals and meet borrower needs while complying with the flood rules, both agencies have issued the guidance discussed in this article. Additionally, FEMA allows greater flexibility to affected borrowers covered by certain NFIP policies. Financial institutions should consider the appropriate guidance when determining how to meet existing flood requirements for borrowers affected by the COVID-19 emergency. When relying upon such guidance to make a decision with respect to complying with flood requirements, financial institutions should carefully document the circumstances, the steps the institution took to comply with the flood rules, and the considerations leading to the decision.

Additional Resources

FRB Flood Insurance Compliance in Response to the Coronavirus
FDIC Coronavirus FAQ
FEMA Bulletin W-20002 ■

Impact of CARES Act on Retirement Accounts

Title II, Subpart B of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) consists of provisions that affect retirement account distributions, charitable contributions, and employer payments on student loans. The following is a summary of the provision affecting retirement accounts.

Several sections of Subpart B effect distributions from retirement accounts including: temporary treatment for coronavirus-related distributions, limited repayment and income tax treatments for qualified individuals, and waivers from required minimum distributions.

Coronavirus-related Distributions

The new law allows for temporary treatment for distributions referred to as "coronavirus-related distributions" (CRDs). For a distribution to be considered a CRD, the distribution need be:

1. Made on or after January 1, 2020 and before December 31, 2020; and

2. Made to an individual:
   (a.) Who is diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention;
   (b.) Whose spouse or dependent (as defined in section 152 of the Internal Revenue Code) is diagnosed with such virus or disease by such a test; or
   (c.) Who experiences adverse financial consequences as a result of being:
   - Quarantined;
   - Furloughed or laid off or having work hours reduced due to such virus or disease; or
   - Unable to work due to lack of childcare due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease, or other factors as determined by the Secretary of the Treasury.

CRDs are permitted for up to $100,000 (in the aggregate) from eligible retirement accounts and are not subject to the standard 10% withholding tax penalty that would otherwise apply to a distribution taken before the participant was 59½. Eligible retirement accounts include qualified defined contribution retirement plans, including 401(k), 403(b), 457(b), and IRAs.

The new law does allow for retirement plan administrators to rely upon an employee certification that he/she meets the CARES Act conditions to make a CRD. There is no further detail in the CARES Act regarding what specific certification should be made for reliance there upon.

CRDs will automatically be included as qualified individual taxable income ratably over a 3-taxable year period beginning with the year withdrawn. The participant may voluntarily elect income treatment differently—such as including CRDs as qualified taxable income all in one tax year.

The CARES Act also allows participants to repay CRDs back to eligible retirement plans and IRAs for which they are beneficiaries and for which a rollover contribution of such distributions can be made. The repayment period is three years from date the distribution was received. Repayments will be treated as satisfying general 60-day rollover requirements and will generally require the participant to file an amended tax return.

Loans from Qualified Retirement Plans

Separate from options available for CRDs, the CARES Act increases the amount qualified individuals may borrow from a qualified retirement plan. From the date of enactment until 180 days thereafter, qualified individuals may borrow up to 100% of the individual's vested account balance or $100,000, whichever is less. This is an increase from current thresholds of 50% and $50,000. A qualified individual is someone that meets the criteria listed in item 2. above. Not all retirement plans allow for participant loans; plan participants should discuss loan options with retirement plan administrators.

In the case of a qualified individual with an outstanding loan from a qualified retirement plan on or after the date of enactment of the CARES Act (March 27, 2020), if the due date for any repayment of the outstanding loan occurs during the period beginning March 27, 2020 and ending December 31, 2020, such due date is delayed for one year. In determining the traditional 5-year period for when a loan from a qualified retirement plan must be repaid, the traditional time period disregards the delayed period.

Waiver of Required Minimum Distribution for 2020

The rules for required minimum distributions (RMDs) for defined contribution plans (such as 403(b) and certain 457(b) accounts) and IRAs have also been impacted by the CARES Act. Under section 2203 of the Act, RMDs are waived for 2020. Due to the changes, an accountholder who was otherwise required to take an RMD in 2020 is no longer required to take the RMD. Additionally, an accountholder who turned 70½ in 2019 but had not yet taken the first RMD by April 1, 2020, is not required to take the first RMD; nor is that accountholder required to take a 2020 RMD.

The RMD changes also impact inherited IRA-holders. If an accountholder inherited an IRA from a person who died before January 1, 2020, the accountholder is not required to take a 2020 RMD. If the accountholder inherited an IRA as a designated beneficiary, the accountholder is generally required have the IRA funds distributed to him/her within a ten-year time period. Under the CARES Act, if the death occurred after December 2019, the ten-year period does not start until 2021—skipping 2020. A non-designated beneficiary (i.e., estate, charity) normally is required to receive the inherited IRA funds over a 5-year period. Under the CARES Act, 2020 is skipped giving the non-designated beneficiary six years to have the IRA funds fully distributed.

A change made by the CARES Act is independent of the Setting Every Community up for Retirement Enhancement Act (SECURE Act). The CARES Act made no changes to the new timing rules of the SECURE Act. Thus, under the SECURE Act, it remains that if an IRA-holder reached 70½ prior to January 1, 2020, or if the IRA-holder is not yet 70½, once the IRA-holder reaches 72 after December 31, 2019, he/she must take an RMD.

Bank Considerations

Given the new distribution flexibilities for retirement accounts, banks should consider whether further tracking of withdrawals should be implemented for distributions made pursuant to the CARES Act. For example, is the bank be able to track the amount of CRDs taken by a qualified individual from an IRA to help ensure the customer did not exceed the $100,000 threshold. Or whether the bank should track CRDs to then anticipate repayments thereof and perhaps monitor both the timing and amount of repayment.

Bank should also consider whether any type of automatic RMD activity need be ceased before an otherwise pre-arranged RMD is disbursed to the customer. Banks should be in contact with those IRA customers in distribution regarding the changes made to RMDs. IRA customers may still decide to voluntarily receive an RMD even though the CARES Act waives the distribution requirement for 2020.

Banks should also become familiar with the frequently asked questions released by the Internal Revenue Service (IRS) regarding the changes made by the CARES Act. In the guidance, IRS references past guidance issued after Hurricane Katrina. It is expected IRS will use the practices implemented in that past disaster in its implementation of the CARES Act changes. IRS needs to issue further guidance for some of the changes made by the CARES Act; banks should keep an eye on the IRS website for that further guidance. The IRS guidance may be viewed at: https://www.irs.gov/newsroom/coronavirus-related-relief-for-retirement-plans-and-iras-questions-and-answers

Conclusion

Title II, Subpart B of CARES Act affect retirement account distributions, charitable contributions, and employer payments on student loans. The changes made to retirement accounts include CRDs, limited repayment and income tax treatments for certain withdrawals made by qualified individuals, and waivers from RMDs for 2020.

Banks should be familiar with guidance issued by the IRS, including a series of frequently asked questions and should consider how the changes may impact IRA operations. Bank should also consider reaching out to IRA customers currently in distribution regarding the opportunity to waive RMDs for 2020. ■

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Regulation D Transaction Limitations

On Tuesday, April 28, 2020, the Board of Governors of the Federal Reserve System (FRB) issued an interim final rule to amend Regulation D to delete the numeric limits on certain kinds of transfers and withdrawals that may be made each month from "savings deposits" (interim final rule or IFR). The interim final rule is effective immediately.

Background

The Federal Reserve Act authorizes FRB to impose reserve requirements on certain types of deposits of depository institutions. Regulation D distinguishes between reservable "transaction accounts" and non-reservable "savings deposits" based on the ease with which the depositor may make transfers or withdrawals from the account. Prior to the interim final rule, Regulation D defined the term "savings deposit" to require, under the terms of the deposit contract or by practice of the depository institution, that the depositor be permitted to make no more than six transfers or withdrawals (in any combination) per calendar month or statement cycle of at least four weeks (six transfer limit).

In January 2019, the Federal Open Market Committee (FOMC) announced its intention to implement monetary policy in an ample reserves regime. Considering that shift, on March 15, 2020, FRB reduced reserve requirement ratios to zero percent effective March 26, 2020, eliminating reserve requirements for all depository institutions. Because of the elimination of reserve requirements on all transaction accounts, the regulatory distinction between reservable "transaction accounts" and non-reservable "savings deposits" is no longer necessary. Thus, FRB issued the IFR to delete the six transfer limit from the definition of "savings deposit."

Impact of the Change and Considerations for Banks

The IFR allows depository institutions to immediately suspend enforcement of the six transfer limit, but does not require any mandatory changes. Because the six transfer limit was deleted, financial institutions may, but are not required to, permit their customers to make an unlimited number of convenient transfers and withdrawals from their savings deposits.

Many financial institutions have questioned whether the deletion of the six transfer limit is permanent. FRB has stated that, as discussed above, the underlying reason enabling the changes in Regulation D is the FOMC's choice of monetary policy framework of an ample reserve regime. In such a regime, reserve requirements are not needed. Thus, the distinction made by the transfer limit between reservable and non-reservable accounts is also not necessary. The FOMC's choice of a monetary policy framework is not a short-term choice. FRB does not have plans to re-impose transfer limits but may make adjustments to the definition of savings accounts in response to comments received on its interim final rule and, in the future, if conditions warrant.

In short, based upon the IFR, and FRB's clarifying statements above, the deletion of the six transfer limit is indefinite. The interim final rule amends Regulation D with no time limitations. FRB could later re-implement the six transfer limit, but would be required to issue a new rule. As discussed above, FRB currently has no plans to re-implement the six transfer limit.

FRB has answered additional frequently asked questions. Some of the more common questions and answers are provided below:

1. **May depository institutions continue to report accounts as "savings deposits" on their FR 2900 reports even after they suspend enforcement of the six-transfer limit on those accounts?**
   Yes. Depository institutions may continue to report these accounts as "savings deposits" on their FR 2900 reports after they suspend enforcement of the six-transfer limit on those accounts.

2. **If a depository institution suspends enforcement of the six-transfer limit on a "savings deposit," may the depository institution report the account as a "transaction account" rather than as a "savings deposit"?**

Yes. If a depository institution suspends enforcement of the six-transfer limit on a "savings deposit," the depository institution may report that account as a "transaction account" on its FR 2900 reports. A depository institution may instead, if it chooses, continue to report the account as a "savings deposit."

3. **May depository institutions suspend enforcement of the six-transfer limit on a temporary basis, such as for six months?**
Yes.

4. **How did the recent amendments to Reg D impact Reg CC?**
Regulation CC provides that an "account" subject to Regulation CC includes accounts described in 12 CFR 204.2(e) (transaction accounts) but excludes accounts described in 12 CFR 204.2(d)(2) (savings deposits). Because Regulation CC continues to exclude accounts described in 12 CFR 204.2(d)(2) from the Reg CC "account" definition, the recent amendments to Regulation D did not result in savings deposits or accounts described in 12 CFR 204.2(d)(2) now being covered by Regulation CC.

In its FAQs, FRB states that the IFR does not specify the manner in which depository institutions that choose to amend their account agreements may do so. Meaning, the IFR, and Regulation D in general, does not require or prescribe how a financial institution must modify its account agreements with respect to the six transaction limitation. However, WBA reminds financial institutions to consider Regulation DD, which implements the Truth in Savings Act.

Regulation DD requires a depository institution to give its consumers 30 calendar days advance notice of any change in a term if the change may reduce the annual percentage yield or adversely affect the consumer. The notice shall include the effective date of the change. If a financial institution decides to remove the six transaction limitation, such a change is positive to the customer and would not require advance notice. Financial institutions might still decide to provide notice of the change from a customer service standpoint, however.

There are other situations that might necessitate advanced notice of a change in terms under Regulation DD. As discussed above, the deletion of the six-month transaction limitation is indefinite. However, financial institutions have the flexibility to choose how to act on that change. Financial institutions could choose to maintain their current policies, procedures, and account agreements, or modify them, and could do so on a temporary basis. For example, a financial institution might decide to permit its customers to make unlimited transactions for a period of six months. At the end of the six-month period, if the financial institution decides to re-implement the six transaction limitation, 30 days advance notice would be required as the change would be adverse to the customer.

Conclusion

FRB's interim final rule deletes the six transaction limit from Regulation D without further limitation. The amendments are intended to allow depository institution customers more convenient access to their funds and to simplify account administration for depository institutions. The IFR permits, but does not require, depository institutions to suspend enforcement of the six transfer limit. Thus, financial institutions have the flexibility to determine whether, and how, to act upon the deletion of the six transfer limit.

Additional Resources

FRB's Interim Final Rule
FRB's Monetary Policy and Reduction of Reserve Requirements
FRB's FAQ on Reserves
FRB's FAQ on Savings Deposits
FRB on Reporting Changes ■

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Wisconsin Bankers ASSOCIATION

June 2020

Compliance Journal

Special Focus

CFPB Issues Proposed Rule to Facilitate LIBOR Transition

On June 4, 2020, the Bureau of Consumer Financial Protection (CFPB) released a notice of proposed rulemaking (proposal) to address the sunset of LIBOR, which is expected to be discontinued after 2021. The proposal would provide examples of replacement indices that meet certain Regulation Z (Reg Z) standards, permit creditors new means to transition home equity lines of credit (HELOCs) and credit card accounts from LIBOR to a replacement index, and address change-in-terms notice provisions.

Reg Z contains separate provisions for HELOCs and open-end credit that is not home secured. These distinctions are important for identifying applicability of various rules, and the proposal amends each separate rule appropriately. However, from a conceptual standpoint, the changes are fundamentally similar. To present these fundamental changes in a manner that is simpler to understand from a conceptual standpoint, and to avoid redundancy, provisions for HELOCs and not home-secured plans have been presented together.

Open-end Credit Subsequent Disclosure Requirements

Reg Z specifies when change-in-terms notifications must be sent to consumers. The transition from LIBOR may trigger certain notification requirements, which CFPB seeks to clarify in the proposal. For example, the proposal would specify that any change-in-terms notice must include any replacement index, including any adjusted margin, regardless of whether the margin is reduced or increased. Reg Z Section 1026.9(c) contains rules for when written change-in-terms notifications are required, both for HELOCs and open-end not home-secured plans. Those rules can be summarized in a way that is relevant to the proposal as follows:

- For HELOCs, a creditor must provide a notice whenever a required term is changed, or the required minimum periodic payment is increased.
- For open-end (not home-secured) plans, a creditor must provide a notice whenever a significant change in required account terms is made.
- Both rules provide an exception from notice requirements when the change involves a reduction of any component of a finance or other charge.

Because the index is a required term, a creditor must provide a change-in-terms notice disclosing the index that is replacing the LIBOR index for both HELOCs and for non-home-secured plans. The exception does not apply to the index change, regardless of whether there is also a change in the index value or margin that involves a reduction in a finance or other charge.

The exception also requires notification of a margin change if the margin is increasing. However, a decrease in the margin would be excepted from the notification requirements because the change would involve a reduction in a component of a finance or other charge. The proposal would revise the exception when the change involves a reduction of any component of a finance or other charge so that it does not apply on or after October 1, 2021, where the creditor is reducing the margin when a LIBOR index is replaced. Thus, the proposal would make it clear that a change-in-terms notice for any replacement index must include any adjusted margin *regardless* of whether the margin is reduced or increased.

The Truth in Lending Act generally requires that changes in disclosures have an effective date of the 1st of October that is at least six months after the date the final rule is adopted. However, in the proposal, CFPB notes that creditors may want to provide the information about the decreased margin in the change-in-terms notice even if they replace the LIBOR index and adjust the margin earlier than October 1, 2021.

Special Focus

Requirements for Home Equity Plans and Credit Cards

Reg Z generally prohibits a creditor from changing the terms of a HELOC except under certain circumstances. Additionally, Reg Z Subpart G contains rules implementing requirements under the Credit CARD Act. In the case of a credit card account under an open-end consumer credit plan, a card issuer may not increase an APR (or certain other charges) except under certain circumstances.

Existing unavailability provisions exist for both HELOC plans and credit card plans, which permits the creditor to change the index and margin. In both instances, the proposal would revise existing unavailability provisions, primarily for technical, conforming, and clarification purposes. The proposal would also create LIBOR-specific provisions and permit a creditor to use either those new provisions or the existing, updated unavailability provisions.

Reg Z currently provides that a creditor may change the index and margin used under either plan under certain circumstances, namely beginning with the situation where the original index has become no longer available. The proposal would update both existing unavailability provisions so that a creditor may change the index and margin used under the plan if the original index is no longer available, the replacement index has historical fluctuations substantially similar to that of the original index, and the replacement index and replacement margin would have resulted in an APR substantially similar to the rate in effect at the time the original index became unavailable. The proposal would also provide that if the replacement index is newly established and therefore does not have any rate history, it may be used if it and the replacement margin will produce an APR substantially similar to the rate in effect when the original index became unavailable. Thus, the proposal would change the existing requirements in the following three ways:

1. Use of the term "historical fluctuations" rather than the term "historical movement" to refer to the original index and the replacement index. This would primarily be a technical change with the revised definition being shaped by conforming changes throughout the rule.

2. Includes a provision regarding newly established indices. A similar provision currently exists in Reg Z requiring newly established indices to produce a rate substantially similar to the original index. The proposal would clarify that the creditor using a newly established index may adjust the margin in order to produce a substantially similar APR.

3. The terms "replacement index" and "replacement index and replacement margin" are used instead of "new index" and "new index and margin." The proposed change is intended to avoid any confusion when the rule refers to a replacement index and replacement margin as opposed to a newly established index.

The proposal would also add new LIBOR-specific provisions to Reg Z. These provisions would permit creditors for both types of plans that use a LIBOR index under the plan to replace the LIBOR index and change the margins for calculating the variable rates on or after March 15, 2021, under certain circumstances, without needing to wait for LIBOR to become unavailable.

Specifically, the proposal would provide that if a variable rate is calculated using a LIBOR index, a creditor may replace the LIBOR index and change the margin for calculating the variable rate on or after March 15, 2021, as long as:

1. The historical fluctuations in the LIBOR index and replacement index were substantially similar; and

2. The replacement index value in effect on December 31, 2020, and replacement margin will produce an APR substantially similar to the rate calculated using the LIBOR index value in effect on December 31, 2020, and the margin that applied to the variable rate immediately prior to the replacement of the LIBOR index used under the plan.

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Additionally, if the replacement index is newly established and therefore does not have any rate history, it may be used if the replacement index value in effect on December 31, 2020, and the replacement margin will produce an APR substantially similar to the rate calculated using the LIBOR index value in effect on December 31, 2020, and the margin that applied to the variable rate immediately prior to the replacement of the LIBOR index used under the plan.

Card Issuer Reevaluation of Rate Increases

Reg Z contains provisions that requires a card issuer to perform an ongoing review for credit card accounts when the APR is increased. Thus, if the LIBOR transition results in an APR increase, a card issuer would be required to complete an analysis reevaluating the rate on that account every 6 months until certain requirements are met. For this purpose, LIBOR must be used as the comparison index.

The proposal would create an exception for those card issuers that transitioned from LIBOR using either Reg Z's existing unavailability provision, or the proposal's LIBOR-specific provision discussed above. The proposal also would provide instructions on how to replace LIBOR as a benchmark for comparison for card issuers who were already required to perform a review as of March 15, 2021.

Where the transition results in an APR increase, no analysis reevaluating the rate would be required. The proposal also would provide instructions on how to replace LIBOR as a benchmark for comparison for card issuers who were already required to perform a § 1026.59 review as of March 15, 2021.

Closed-end Loan Considerations

Pursuant to Reg Z, if a creditor changes the index of a variable-rate closed-end loan to an index that is not a "comparable index," the index change may constitute a refinancing for purposes of Regulation Z, triggering certain requirements. The proposal would provide an example of an index that is a "comparable index" to LIBOR for closed-end products. Specifically, CFPB would add an illustrative example to identify the Secured Overnight Financing Rate-based spread-adjusted replacement indices recommended by the Alternative Reference Rates Committee as an example of a "comparable index" for the LIBOR indices that are intended to be replaced.

Conclusion

CFPB's proposal would provide examples of replacement indices for LIBOR, permit a means for creditors to transition existing accounts that use LIBOR to a replacement index, address change-in-terms notice provisions, and address the rate reevaluation provisions applicable to credit card accounts. Financial institutions using LIBOR as an index for calculating rates for open-end and closed-end products should consider how these changes affect their plans for the transition to replacement indices. As noted above, this article has been presented to help understand the proposal on a conceptual level. As such, financial institutions should refer to the applicable provisions within the proposal itself depending on the types of products they offer for more specific requirements. CFPB has also provided FAQs (which includes other transition topics in addition to the proposal) and "fast facts" regarding the proposal. Questions can also be directed to the WBA Legal Call program at wbalegal@wisbank.com.

CFPB's Proposed Rule

CFPB's FAQs

CFPB's Fast Facts ■

Wisconsin Bankers Association

July 2020

Compliance Journal

Special Focus

An Update on Hemp

On December 20, 2018, the Agriculture Improvement Act of 2018 (2018 Farm Bill) was signed into law. Previously, under the 2014 Farm Bill, production of hemp was permitted for research purposes only. Many States, including Wisconsin, implemented research programs under the 2014 Farm Bill. The 2018 Farm Bill contains provisions clarifying the status of hemp, transitioning it from a research crop to a commodity. The 2018 Farm Bill thus necessitates revision to existing programs regulating hemp production.

In Wisconsin, hemp production continues to be legal under existing State programs, implemented under the 2014 Farm Bill. However, financial institutions should be aware that those requirements are shifting, and policy adjustments should be made accordingly. This article provides a background and reminder of hemp's status under the law, timelines of the shift to 2018 Farm Bill programs, practical considerations, and recent activity from the Financial Crimes Enforcement Network (FinCEN) and the Wisconsin Department of Agriculture, Trade and Consumer Protection (DATCP).

Background and Status of Hemp in Wisconsin

The 2018 Farm Bill clarifies the legality of hemp, and sets all pilot programs established under the 2014 Farm Bill to expire on October 31, 2020. Late last year, the United States Department of Agriculture (USDA) published an interim final rule specifying regulations governing the production of hemp in accordance with the 2018 Farm Bill. Wisconsin also responded with 2019 Wisconsin Act 68 (Act 68) to make several changes to its laws governing industrial hemp. USDA's rule establishes a Federal program governing hemp production nationally. It also outlines provisions under which States may submit their own plan for approval under the Federal program. Thus, States are automatically subject to the Federal program, unless their program is approved. Wisconsin Act 68 directs DATCP to write new rules, and the expectation is for DATCP to submit its plan to USDA for approval under the Federal program.

Previously, 2017 Wisconsin Act 100 implemented Wisconsin's current program (pilot program), pursuant to the 2014 Farm Bill, and DATCP wrote EmR1807 (prior rule) in 2018 implementing the pilot program. DATCP issued licenses beginning late last year under the pilot program, and hemp can be grown and produced legally during Wisconsin's 2020 hemp season by meeting existing program requirements, as discussed in more detail below. DATCP expects to begin a new program under the 2018 Farm Bill, pending USDA's approval, in 2021.

DATCP's Emergency Rule

DATCP's prior rule implementing the pilot program expired on July 1, 2020. Before expiration, on June 27, 2020, DATCP issued EmR2016 (emergency rule) to maintain the program until October 31, 2020, when the pilot program terminates. The emergency rule also makes the following changes to the program to conform to the 2018 Farm Bill and Act 68:

- Updates the definition of hemp.
- Adds definitions for the terms "THC" and "decarboxylated" to clearly state regulatory testing requirements and to provide additional clarity that THC content includes THC-A, consistent with state and federal law, and existing testing requirements.
- Uses the term "lot" instead of "crop" to more clearly explain how regulatory sampling and testing requirements apply to all hemp.
- Uses the term "growing location" instead of "field" and "greenhouse" to refer to where hemp is grown.
- Clarifies that after a failed initial test, the entire lot must be destroyed within 10 days after service of DATCP's destruction order unless the grower requests a re-test prior to the expiration of the 10 days.

- Clarifies that a grower cannot request a re-test of the original sample, but that a grower can request a new sample be collected for re-testing by DATCP.

- Clarifies that a lot must be sampled prior to harvest, but that a lot does not need to be tested prior to harvest.

- Clarifies that a fit for commerce certificate must be obtained by a grower prior to the hemp being transported from the growing location. Allows for movement of harvested hemp within, but not from, a growing location.

- Clarifies that hemp found without a required fit for commerce certificate is subject to destruction.

- Clarifies that a grower with unpaid invoices may not annually register and may be subject to license suspension.

- Updates requirements for the planting report and final report to meet current program practices.

- Updates requirements that a licensee must notify DATCP in writing of the variety of hemp they intend to plant before planting. Licensees may plant only approved varieties.

- Updates the dates and deadlines for transitioning to a new hemp program under the USDA.

The emergency rule will remain in effect until Wisconsin's hemp pilot research program expires on October 31, 2020. At that time, DATCP will transition to a new program under the USDA interim final rule. WBA will provide updates as more information from DATCP becomes available on the transition.

FinCEN Guidance Regarding BSA Due Diligence Requirements

On June 29, 2020, the Financial Crimes Enforcement Network (FinCEN) issued guidance on Bank Secrecy Act (BSA) requirements for hemp-related business customers. The guidance provides that, in addition to conducting customer due diligence (CDD) on hemp-related businesses at time of application, financial institutions must establish risk-based procedures for conducting ongoing CDD. Specifically, for customers who are hemp growers, financial institutions may confirm the hemp grower's compliance with state, tribal government, or the USDA licensing requirements, as applicable, by either obtaining:

1. A written attestation by the hemp grower that they are validly licensed, or

2. A copy of such license.

Financial institutions might also consider seeking additional information based upon their assessment of potential risk posed by each customer. FinCEN suggests that additional information might include crop inspection or testing reports, license renewals, updated attestations from the business, or correspondence with the state, tribal government, or USDA. It is important for financial institutions to know the nature of their customer's business to best determine their risk profile.

The guidance also clarifies that because hemp is no longer a Schedule I controlled substance, financial institutions are not required to file a Suspicious Activity Report on customers solely because they are engaged in the growth or cultivation of hemp in accordance with applicable laws and regulations. Lastly, the guidance confirms that financial institutions must report currency transactions in connection with hemp-related businesses in the same manner they would for any other customers.

Practical Considerations

A key takeaway is that the 2018 Farm Bill removed hemp from the definition of marijuana in the Controlled Substances Act. These changes shift toward treating hemp as a regulated commodity. The new

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regulatory framework starts with USDA's interim final rule, which sets the stage for State programs. WBA published an article that explores USDA's interim final rule in greater detail, which is included below.

From a Wisconsin standpoint, as discussed above, Wisconsin will continue to operate under the pilot program (as revised by emergency rule) until October 31, 2020. It is important to note that 2019 Act 68, and DATCP's emergency rule does not relate specifically to financial institutions. However, as seen in FinCEN's guidance, financial institutions are expected to conduct due diligence on hemp-related businesses. Thus, it is important to understand how the industry operates, and is regulated.

DATCP's emergency rule offers clarity in areas not covered under its previous rule. The extent to which a financial institution will need to be familiar with these requirements depends on its customer base. For example, a customer might be looking to just try hemp on a small field they have available. Another might have a large production operation that involves the purchase of large quantities of different seed varieties, and the harvest and shipping of hemp for uses of both oil and fiber. The extent to which a financial institution gathers information in either scenario may depend on the perceived risk of each business' operation.

In either case, financial institutions should start with licensure, knowing that is FinCEN's minimum requirement, and work from there. Next steps will likely involve a discussion with the customer to better understand their operation. This way, a financial institution can gather information to make its own business decisions, and meet BSA requirements. Some financial institutions may wish to accomplish this by obtaining certifications from their customers. For financial institutions looking to use this method, WBA has created a hemp questionnaire and certification available through FIPCO, which has been designed with DATCP's program requirements in mind.

Conclusion

Wisconsin's pilot program, under which currently licensed growers and processors currently operate, expires on October 31, 2020. Hemp-related businesses may continue to operate under the existing program, but later this year, DATCP will provide new information on a transition to a new program under the USDA interim final rule. While WBA does not anticipate the new program will place any new requirements on financial institutions, it is important to be aware of the changes when they occur from a know-your-customer standpoint for both the business and BSA considerations discussed above. WBA will report upon the details of the new program when they become available.

Additional Resources

DATCP Notice to Stakeholders
DATCP Emergency Rule Text
DATCP Table of Changes
FinCEN Guidance
WBA Article on USDA Interim Final Rule ■

Treatment of Certain COVID-19 Related Loss Mitigation Option Under Regulation X

The Bureau of Consumer Financial Protection (CFPB) issued an interim final rule in late June to amend Regulation X, which implements the Real Estate Settlement Procedures Act (RESPA), to temporarily permit mortgage servicers to offer a loss mitigation option based on the evaluation of an incomplete loss mitigation application. This article provides a summary of the interim rule.

Background and Rationale for New Rule

A general understanding of the current compliance requirements of loss mitigation and recent mortgage servicing activity which has resulted due to the pandemic is necessary to better understand the nuances for the newly created mitigation option under the interim fi-regulatory framework starts with USDA's interim final rule, which sets the stage for State programs. WBA published an article that explores USDA's interim final rule in greater detail, which is included below.

From a Wisconsin standpoint, as discussed above, Wisconsin will continue to operate under the pilot program (as revised by emergency rule) until October 31, 2020. It is important to note that 2019 Act 68, and DATCP's emergency rule does not relate specifically to financial institutions. However, as seen in FinCEN's guidance, financial institutions are expected to conduct due diligence on hemp-related businesses. Thus, it is important to understand how the industry operates, and is regulated.

DATCP's emergency rule offers clarity in areas not covered under its previous rule. The extent to which a financial institution will need to be familiar with these requirements depends on its customer base. For example, a customer might be looking to just try hemp on a small field they have available. Another might have a large production operation that involves the purchase of large quantities of different seed varieties, and the harvest and shipping of hemp for uses of both oil and fiber. The extent to which a financial institution gathers information in either scenario may depend on the perceived risk of each business' operation.

In either case, financial institutions should start with licensure, knowing that is FinCEN's minimum requirement, and work from there. Next steps will likely involve a discussion with the customer to better understand their operation. This way, a financial institution can gather information to make its own business decisions, and meet BSA requirements. Some financial institutions may wish to accomplish this by obtaining certifications from their customers. For financial institutions looking to use this method, WBA has created a hemp questionnaire and certification available through FIPCO, which has been designed with DATCP's program requirements in mind.

Conclusion

Wisconsin's pilot program, under which currently licensed growers and processors currently operate, expires on October 31, 2020. Hemp-related businesses may continue to operate under the existing program, but later this year, DATCP will provide new information on a transition to a new program under the USDA interim final rule. While WBA does not anticipate the new program will place any new requirements on financial institutions, it is important to be aware of the changes when they occur from a know-your-customer standpoint for both the business and BSA considerations discussed above. WBA will report upon the details of the new program when they become available.

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Background and Rationale for New Rule

A general understanding of the current compliance requirements of loss mitigation and recent mortgage servicing activity which has resulted due to the pandemic is necessary to better understand the nuances for the newly created mitigation option under the interim final rule. As a requirement of the Dodd-Frank Act, Regulation X (Reg X) was revised in 2013 to create a uniform set of procedures that mortgage servicers must follow when offering loss mitigation options to borrowers who have failed to meet the contractual obligations of their mortgage loan. The loss mitigation procedures are found in Reg X section 1024.41.

Under current Reg X loss mitigation procedures, servicers are required to first obtain a complete loss mitigation application from the borrower before evaluating a borrower for a loss-mitigation option, such as a loan modification or short sale. Reg X defines a "complete loss mitigation application" to mean an application in connection with which a servicer has received all the information that the servicer requires from a borrower in evaluating applications for the loss mitigation options available to the borrower. A servicer is required to exercise reasonable diligence in obtaining documents and information to a complete loss mitigation application; failure to do so could result in compliance exam violations and potential civil money penalties.

Reg X compliance requirements aside, financial institutions have now had to deal with various responses to the national emergency due to the novel coronavirus disease (COVID-19) including actions taken by mortgage owners, investors, and insurers of mortgage loans under payment forbearance programs. In particular, the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Company (Freddie Mac), Federal Housing Administration (FHA), Federal Home Loan Bank Chicago, and other owners or insurers of mortgage loans previously announced forbearance loan programs to assist borrowers with mortgage payments knowing many would not be able to work due to the steps taken under the COVID-19 national emergency. These parties also then created payment deferral programs for borrowers once they exit forbearance to help those borrowers who are unable to afford full reinstatement or a repayment plan at that time.

Additionally, section 4022 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) allows borrowers who are experiencing financial hardship due, directly or indirectly, to the COVID-19 emergency and who have a federally-backed mortgage to have access to payment forbearance programs if the borrower submits a request to their mortgage servicer and affirms that they are experiencing a financial hardship during the COVID-19 emergency. Unfortunately, the CARES Act does not specify how borrowers who received a CARES Act forbearance must repay forborne payments.

Given the actions by Fannie Mae, Freddie Mac and other investors/insurers to utilize forbearance and deferral programs and the requirements under the CARES Act, mortgage servicers need to reconcile those actions and requirements with the Reg X loss mitigation compliance rules to ensure no compliance violations are cited.

As stated above, Reg X requires mortgage servicers to offer loss mitigation options only after the servicer has evaluated a complete loss mitigation application. To further ensure servicers comply with the requirement, Reg X section 1024.41(c)(2)(i) contains what is generally referred to as the "anti-evasion" rule whereby mortgage servicers cannot evade the requirement to evaluate a complete loss mitigation application for all loss mitigation options available to the borrower by offering a loss mitigation option based upon the evaluation of any information provided by a borrower in connection with an incomplete loss mitigation application except for in only two instances:

(1) borrower delays completing a loss mitigation application for a significant period of time; and

(2) for a "short-term" mitigation plan.

The programs being offered by mortgage owners/insurers and under the CARES Act were typically programs that would not fall within the Reg X 1024.41(c)(2) exceptions to allow a mortgage servicer to offer a loss mitigation option after review of an incomplete loss mitigation application.

The federal banking supervisory agencies attempted to bring clarity to the issue in a joint statement issued on April 3, 2020. In that statement, the agencies, in recognizing the impact the COVID-19 emergency was having on borrowers and on the operations of mortgage servicers, explained that, when a borrower requests a CARES Act forbearance and reaffirms that the borrower has experienced financial hardship during the COVID-emergency, it constitutes an incomplete loss mitigation application under Reg X. The agencies further stated that although receipt of an incomplete loss mitigation application generally triggers a mortgage servicer's good faith obligations under Reg X sec. 1024.41, the joint statement provided that a CARES Act forbearance qualifies as a short-term payment forbearance program under Reg X, so certain loss mitigation requirements under Reg X do not apply. This position, however, was only in a jointly issued statement, not in Regulation.

Special Focus

In recognizing the unique environment created as a result of COVID-19 and all that has been outlined above, CFPB has amended the Reg X loss mitigation rules to create a third exception. New Reg X section 1024.41(c)(2)(v) allows a mortgage servicer to offer a loss mitigation option that meets certain criteria based on the evaluation of an incomplete application, and that servicers need not comply with certain Reg X requirements once a borrower accepts that option. To participate, the interim final rule requires certain criteria be met as is outlined next; CFPB structured its criteria to align with Fannie Mae/Freddie Mac COVID-19 payment deferral and other comparable programs, including FHA's COVID-19 partial claim.

Eligibility Requirements of New Exception

The interim final rule conditions eligibility for the new exception on the loss mitigation option satisfying three criteria:

- First, the loss mitigation option must permit a borrower to delay paying certain amounts until the mortgage loan is refinanced, the mortgaged property is sold, the term of the mortgage loan ends, or for a mortgage insured by FHA, the mortgage insurance terminates.

  These amounts include, without limitation, all principal and interest payments forborne under the payment forbearance program made available to borrowers experiencing a financial hardship due directly or indirectly to COVID-19 emergency, including one made pursuant to the CARES Act.

  These amounts also include, without limitation, all other principal and interest payments that are due and unpaid by the borrower experiencing financial hardship due, directly or indirectly, to the COVID-19 emergency.

  For this criterion, the term of mortgage loan means the term of the mortgage loan according to the obligation between the parties in effect when the borrower is offered the loss mitigation option.

- Second, any amounts that the borrower may delay paying through the loss mitigation option do not accrue interest; servicer does not charge any fee in connection with the loss mitigation option; and the servicer waives all existing late charges, penalties, stop payment fees, or similar charges promptly upon the borrower's acceptance of the loss mitigation option. The interim final rule provides no definition or clarity by what is meant by "or similar charges" under this criterion.

- Third, the borrower's acceptance of the loss mitigation offer must resolve any prior delinquency.

Reg X Mitigation Steps Servicer is Exempt From Under New Rule

If a borrower accepts an option offered pursuant to the new exception, the servicer is not required to continue the reasonable diligence efforts under Reg X section 1024.41(b)(1) or send the acknowledgment notice Reg X section 1024.41(b)(2) would otherwise require for those who are not considered a small servicer under Reg X loss mitigation rules.

Items Mortgage Servicers Should Consider

There are a number of items compliance officers of mortgage servicers may want to consider in connection with CFPB's interim final rule. First being that the rule was effective July 1st. Is the bank ready to implement the interim final rule should it determine the interim rule is a desired process? If bank decides the option is something it will implement, for which mortgage loans will the option be made available? The interim rule allows the new mitigation option for Fannie Mae or Freddie Mac loans as well as other loans, including bank's own portfolio loans.

Also, note that it is not a requirement that the bank offer this option to its borrowers. The bank can certainly follow its normal loss mitigation process established under Reg X section 1024.41 and proceed to collect a complete loss mitigation application and follow its normal protocol established to meet its reasonable diligence in obtaining documents and information to a complete loss mitigation application from borrowers.

If implementing the new mitigation option, how will bank record or validate that the borrower's financial hardship is COVID-19 related? A criterion is that the deferred amounts are not to accrue interest, how will bank code or program its loan operating system to ensure that treatment is applied? What steps will be implemented to ensure those fees that are required to be waived under the rule are waived?

While the rule is effective now, will bank wait until a final rule is issued before it implements this option? If implementing now, bank will need to reevaluate when the rule is finalized to ensure any change made in the promulgation process are implemented into bank's own procedures.

Conclusion

CFPB has created a new exemption under Reg X loss mitigation rules to allow mortgage servicers to offer a particular loss mitigation option to borrowers so long as the criterion in the interim final rule are met, including waiving fees and bringing the loan current. The rule allows servicers to offer the loss mitigation option without having to first receive a complete loss mitigation application. The interim final rule is effective July 1, 2020 and may be viewed at this link. Comments regarding the new option are due August 14th. ■

Regulatory Spotlight

Agencies Issue Final and Interim Rules on Margin and Capital Requirements for Covered Swap Entities.

- The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Farm Credit Administration (FCA), and Federal Housing Finance Agency (FHFA) (collectively, the agencies) adopted a final rule to amend regulations requiring swap dealers and security-based swap dealers under the agencies' respective jurisdictions to exchange margin with their counterparties for swaps that are not centrally cleared (Swap Margin Rule). The Swap Margin Rule as adopted in 2015 takes effect under a phased compliance schedule spanning from 2016 through 2020. The entities covered by the rule continue to hold swaps in their portfolios that were entered into before the effective dates of the rule; such swaps are grandfathered from the Swap Margin Rule's requirements until they expire according to their terms. The final rule: (1) permits swaps entered into prior to an applicable compliance date (legacy swaps) to retain their legacy status in the event that they are amended to replace an interbank offered rate (IBOR) or other discontinued rate; (2) modifies initial margin requirements for non-cleared swaps between affiliates; (3) introduces an additional compliance date for initial margin requirements; (4) clarifies the point in time at which trading documentation must be in place; (5) permits legacy swaps to retain their legacy status in the event that they are amended due to technical amendments, notional reductions, or portfolio compression exercises; and (6) makes technical changes to relocate the provision addressing amendments to legacy swaps that are made to comply with the Qualified Financial Contract Rules, as defined in the Supplementary Information section of the final rule. In addition, the final rule addresses comments received in response to the agencies' interim final rule that would preserve the status of legacy swaps meeting certain criteria if the United Kingdom withdraws from the European Union ("Brexit") without a negotiated settlement agreement. The final rule is effective **08/31/2020**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-07-01/pdf/2020-14097.pdf. *Federal Register*, Vol. 85, No. 127, 07/01/2020, 39754-39780.

- The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Farm Credit Administration (FCA), and Federal Housing Finance Agency (FHFA) (collectively, the agencies) adopted an interim final rule to amend regulations that require swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants under the agencies' respective jurisdictions to exchange margin with their counterparties for swaps that are not centrally cleared (non-cleared swaps) (Swap Margin Rule). Under the Swap Margin Rule, as amended, initial margin requirements will take effect under a phased compliance schedule spanning from 2016 through 2020. Due to the COVID-19 pandemic, the agencies are extending by one year the phases 5 and 6 implementation deadlines for initial margin requirements from **09/01/2020**, to **09/01/2021** (for phase 5) and from **09/01/2021**, to **09/01/2022** (for phase 6). The interim final rule is effective **09/01/2020**. Comments are due **08/31/2020**. The interim final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-07-01/pdf/2020-14094.pdf. *Federal Register*, Vol. 85, No. 127, 07/01/2020, 39464-39470.

Agencies Issue Guidance for Assessing Safety and Soundness Given Effect of COVID-19 Pandemic on Institutions.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and National Credit Union Administration (NCUA), in conjunction with the state bank and credit union regulators (CSBS), issued an examiner guidance to outline the supervisory principles for assessing the safety and soundness

While the FAQs clarify certain activities that are not specifically required, it is important to note that under certain circumstances, the concepts discussed above might be appropriate. Financial institutions must set policies and procedures to meet CDD requirements. Those policies must guide, in accordance with the considerations above, determinations as to what information the financial institution collects at account opening, how a customer relationship is risk-weighted, and what, if any, ongoing monitoring is performed. Thus, financial institutions should still review existing CDD policies and procedures considering the new FAQs.

The FAQs can be found here. ■

CFPB HMDA FAQs

On July 7, 2020, the Bureau of Consumer Financial Protection (CFPB) issued two new frequently asked questions regarding Regulation C, Home Mortgage Disclosure Act (HMDA), reporting requirements for financial institutions. The FAQs discuss reporting of multiple data points when certain factors are relied upon in making a credit decision.

Multiple Data Points

The first question asks whether financial institutions are required to report the credit score, debt-to-income ratio (DTI), and combined loan-to-value ratio (CLTV) relied on in making a credit decision when such data is not the dispositive factor? CFPB responds that yes, credit underwriting data such as credit score, DTI, and CLTV must be reported if they were a factor relied on in making a credit decision—even if the data was not the dispositive factor.

For purposes of Regulation C, it does not matter whether the application is approved or denied; if certain data was relied on in making a credit decision, such data must be reported. For example, if the credit score was relied on in making a credit decision, the credit score must be reported. If the financial institution denied the application because the application did not satisfy one or more underwriting requirements other than the credit score, the financial institution is still required to report the credit score relied on. The same analysis applies to the reporting of CLTV and DTI.

The second question asks if, when income and property value are factors in the credit decision, though not the dispositive factor, should such data points be reported? CFPB responds that yes, when a credit decision is made, Regulation C requires reporting of the data "relied on in making the credit decision." Hence, if these data are relied on in making a credit decision, such data must be reported.

There is no requirement in Regulation C for either of these data points to be the dispositive factor in order to be reported. Specifically, the commentary explains that when a financial institution evaluates income as part of a credit decision, it must report the gross annual income relied on in making the credit decision. For example, if an institution relies on the verified gross income of an applicant to make a credit decision, the institution is required to report the verified gross income. The comment does not state that verified gross annual income must be dispositive in the credit decision.

The commentary also provides a similar narrative for property value. Income and property value apply the relied-on standard in a similar way to credit score, DTI, and CLTV and should therefore be reported if relied on in making a credit decision.

Conclusion

The FAQs emphasize specific factors that, when relied upon in making a credit decision, must be reported. The data points are required even when the information is not the dispositive factor in a credit decision.

The FAQs can be found here: https://files.consumerfinance.gov/f/documents/cfpb_HMDA_frequently-asked-questions.pdf ■

The agencies also encourage financial institutions to provide consumers with available options for repaying any missed payments at the end of their accommodation to avoid delinquencies or other adverse consequences. The agencies also encourage institutions, where appropriate, to provide consumers with options for making prudent changes to the terms of the credit product to support sustainable and affordable payments for the long term. Eight examples of generally effective approaches to risk management in this context are included in the guidance.

The new guidance also includes a discussion regarding accounting and regulatory reporting that financial institutions need to consider for all loan modifications, including additional modifications for borrowers who may continue to experience financial hardship at the end of the initial accommodation period. Institutions are reminded to consider regulatory reporting instructions, section 4013 of the CARES Act regarding temporary relief from troubled debt restructuring, and the *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)*.

Lastly, the guidance sets forth the importance of internal control functions, commensurate with the size, complexity, and risk of a financial institution's activities. The internal control functions typically include appropriate targeted testing of the process for managing each stage of the accommodation. Included in the new guidance are six examples of the type of activity the agencies believe can be confirmed through prudent testing by a financial institution's internal control functions.

As financial institutions work to determine whether certain borrowers need additional accommodations due to the effects of the COVID event, and in preparation of federal and state examinations resuming, the new guidance provides examples of prudent risk management and consumer protection principles that each financial institution need weigh. Additionally, the new guidance provides factors to consider when working through accounting and regulatory reporting requirements as it relates to each particular credit. The new interagency statement may be viewed at: www.ffiec.gov/press/PDF/Statement_for_Loans_Nearing_the_End_of_Relief_Period.pdf ■

FinCEN CDD FAQs

On August 3, 2020, the Financial Crimes Enforcement Network (FinCEN) issued three new frequently asked questions regarding customer due diligence (CDD) requirements for financial institutions. The new FAQs clarify the regulatory requirements related to obtaining customer information, establishing a customer risk profile, and performing ongoing monitoring of the customer relationship.

Risk-Based Procedures

The first question in the FAQs asks whether financial institutions must request certain information at account opening and on an ongoing basis. Specifically, must a financial institution:

- collect information about expected activity on all customers at account opening, or on an ongoing or periodic basis;
- conduct media searches or screening for news articles on all customers or other related parties, such as beneficial owners, either at account opening, or on an ongoing or periodic basis; or
- collect information that identifies underlying transacting parties when a financial institution offers correspondent banking or omnibus accounts to other financial institutions (i.e., a customer's customer)?

FinCEN responds that the CDD Rule does not categorically require:

1. the collection of any particular customer due diligence information (other than that required to develop a customer risk profile, conduct monitoring, and collect beneficial ownership information);

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2. the performance of media searches or particular screenings; or

3. the collection of customer information from a financial institution's clients when the financial institution is a customer of a covered financial institution.

FinCEN explains that a financial institution must make a risk assessment of the customer to determine whether additional information is necessary in order to develop its understanding of the nature and purpose of the customer relationship. Financial institutions must establish policies, procedures, and processes for determining whether and when, on the basis of risk, to update customer information to ensure that customer information is current and accurate.

Customer Risk Profile

The second question asks whether covered financial institution must:

- use a specific method or categorization to risk rate customers; or

- automatically categorize as "high risk" products and customer types that are identified in government publications as having characteristics that could potentially expose the institution to risks?

FinCEN responds that it is not a requirement for financial institutions to use a specific method or categorization to establish a customer risk profile. Further, financial institutions are not required or expected to automatically categorize as "high risk" products or customer types listed in government publications.

Various government publications provide information and discussions on certain products, services, customers, and geographic locations that present unique challenges and exposures regarding illicit financial activity risks. However, even within the same risk category, a spectrum of risks may be identifiable and due diligence measures may vary on a case-by-case basis.

A covered financial institution should have an understanding of the money laundering, terrorist financing, and other financial crime risks of its customers to develop the customer risk profile. Furthermore, the financial institution's program for determining customer risk profiles should be sufficiently detailed to distinguish between significant variations in the risks of its customers. There are no prescribed risk profile categories, and the number and detail of these categories can vary.

Ongoing Monitoring of the Customer Relationship

The third question asks whether it is a requirement that financial institutions update customer information on a specific schedule. FinCEN answers that there is no categorical requirement that financial institutions update customer information on a continuous or periodic schedule.

The requirement to update customer information is risk based and occurs as a result of normal monitoring. Should a financial institution become aware, as a result of its ongoing monitoring of a change in customer information (including beneficial ownership information) that is relevant to assessing the risk posed by the customer, the financial institution must update the customer information accordingly. Additionally, if the customer information is relevant to assessing the risk of a customer relationship, then the financial institution should reassess the customer risk profile/rating and follow its established policies, procedures, and processes for maintaining or changing the customer risk profile/rating. However, financial institutions, on the basis of risk, may choose to review customer information on a regular or periodic basis.

Conclusion

The FAQs help to further shape the requirements of the CDD rule. In summary, they provide that financial institutions are not automatically required to collect particular categories of information, perform screenings, or gather information for a customer's customer (when working with another financial institution). The rule also does not set a method for establishing risk profile, or require certain risk profiles based upon listings in government publications. Lastly, there is no requirement to update customer information on a continual basis.

While the FAQs clarify certain activities that are not specifically required, it is important to note that under certain circumstances, the concepts discussed above might be appropriate. Financial institutions must set policies and procedures to meet CDD requirements. Those policies must guide, in accordance with the considerations above, determinations as to what information the financial institution collects at account opening, how a customer relationship is risk-weighted, and what, if any, ongoing monitoring is performed. Thus, financial institutions should still review existing CDD policies and procedures considering the new FAQs.

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There is no requirement in Regulation C for either of these data points to be the dispositive factor in order to be reported. Specifically, the commentary explains that when a financial institution evaluates income as part of a credit decision, it must report the gross annual income relied on in making the credit decision. For example, if an institution relies on the verified gross income of an applicant to make a credit decision, the institution is required to report the verified gross income. The comment does not state that verified gross annual income must be dispositive in the credit decision.

The commentary also provides a similar narrative for property value. Income and property value apply the relied-on standard in a similar way to credit score, DTI, and CLTV and should therefore be reported if relied on in making a credit decision.

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Wisconsin Bankers ASSOCIATION

August 2020

Compliance Journal

Special Focus

Statement on Additional Loan Accommodations Due to COVID-19 as Many Near End of Initial Loan Accommodation Period

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and National Credit Union Administration (NCUA) (collectively, the agencies) recently issued a joint statement to provide prudent risk management and consumer protection principles for financial institutions to consider while working with borrowers as loans near the end of initial loan accommodation periods applicable during the Coronavirus Disease 2019 (COVID event). The principles are consistent with the agencies' *Interagency Guidelines Establishing Standards for Safety and Soundness* and are generally applicable to both commercial and retail loan accommodations. The principles are intended to be tailored to a financial institution's size, complexity, and loan portfolio risk profile, as well as the industry and business focus of its customers. The following is a summary of the release.

In the new guidance, the agencies recognize that while some borrowers will be able to resume contractual payments at the end of an accommodation, others may be unable to meet their obligations due to continuing financial challenges. The agencies also recognize that some financial institutions may face difficulties in assessing credit risk due to limited access to borrower financial data, COVID event-induced covenant breaches, and difficulty in analyzing the impact of COVID event-related government assistance programs.

The agencies provide several principles to illustrate prudent practices for financial institutions in working with borrowers as loans near the end of accommodation periods, including: prudent risk management practices, well-structured and sustainable accommodations, consumer protection, accounting and regulatory reporting, and internal control systems.

As outlined by the agencies, prudent risk management practices include identifying, measuring, and monitoring the credit risks of loans that receive accommodations. Sound credit risk management practices include applying appropriate loan risk ratings or grades and making appropriate accrual status determinations on loans affected by the COVID event. Further, the agencies believe effective management information systems and reporting helps to ensure that bank management understands the scope of loans that received an accommodation, the types of initial and any additional accommodations provided, when the accommodation periods end, and the credit risk of potential higher-risk segments in the portfolios.

When working with borrowers who continue to experience financial challenges after an initial accommodation, the agencies believe it may be prudent for a financial institution to consider additional accommodation options to mitigate losses for the borrower and the financial institution. The effectiveness of accommodations improves when they are based on a comprehensive review of how the hardship has affected the financial condition and current and future performance of the borrower.

When considering whether to offer additional accommodation options to a borrower, the agencies stated it is generally appropriate for the institution to assess each loan based upon the fundamental risk characteristics affecting the collectability of that particular credit. The new guidance further identifies what financial institutions should consider in its evaluation of the borrower's financial condition and repayment capacity. The agencies also note that the COVID event may have a long-term adverse impact on a borrower's future earnings and therefore bank management may need to rely more heavily on projected financial information for both commercial and retail borrowers when making underwriting decisions as supporting documentation may be limited, and cash flow projections may be uncertain.

The agencies also encourage financial institutions to provide consumers with available options for repaying any missed payments at the end of their accommodation to avoid delinquencies or other adverse consequences. The agencies also encourage institutions, where appropriate, to provide consumers with options for making prudent changes to the terms of the credit product to support sustainable and affordable payments for the long term. Eight examples of generally effective approaches to risk management in this context are included in the guidance.

The new guidance also includes a discussion regarding accounting and regulatory reporting that financial institutions need to consider for all loan modifications, including additional modifications for borrowers who may continue to experience financial hardship at the end of the initial accommodation period. Institutions are reminded to consider regulatory reporting instructions, section 4013 of the CARES Act regarding temporary relief from troubled debt restructuring, and the *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)*.

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Wisconsin Bankers ASSOCIATION

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Compliance Journal

Special Focus

CFPB Proposes Seasoned QM Category

The Bureau of Consumer Financial Protection (CFPB) has proposed the creation of a new category of qualified mortgages (QM) named, Seasoned QM.

As a general matter, the Ability-to-Repay/Qualified Mortgage Rule (ATR Rule) requires a creditor to make a reasonable, good faith determination of a consumer's ability to repay a residential mortgage loan according to its terms. Loans that meet the ATR Rule requirements for QMs obtain certain protections from liability. CFPB stated it created the Seasoned QM category to complement existing QM definitions and to help ensure access to responsible, affordable mortgage credit—especially given the upcoming sunset of the temporary GSE QM category. CFPB also stated it seeks to encourage safe and responsible innovation in the mortgage origination market, including for certain loans that are not QMs or are only rebuttable presumption QMs under existing QM categories.

Under the proposed rule, a covered transaction would receive a safe harbor from ATR liability at the end of a 36-month seasoning period as a Seasoned QM if it satisfies certain product restrictions, points-and-fees limits, and underwriting requirements. The following is an overview of the restrictions and requirements of the proposed Seasoned QM.

Product Restrictions and Underwriting Requirements

A covered transaction must meet the following product restrictions to be eligible to become a Seasoned QM:

1. The loan is secured by a first lien;

2. The loan has a fixed rate, with fully amortizing payments, and no balloon payment;

3. The loan term does not exceed 30 years; and

4. The total points and fees do not exceed 3 percent of the loan amount.

For a loan to be eligible to become a Seasoned QM, the proposal requires that the bank consider the consumer's debt-to-income (DTI) ratio or residual income and verify the consumer's debt obligations and income. Similar to the existing Small Creditor QM category, the proposal does not specify a DTI limit. Additionally, the bank is not required to use Appendix Q to Regulation Z in calculating and verifying debt and income. The proposed commentary provides that a loan that complies with the consider and verify requirements of any other QM definition is deemed to comply with the consider and verify requirements of the Seasoned QM.

Portfolio Requirement

The proposed rule also sets forth a portfolio requirement for the new category. To be a Seasoned QM, the covered transaction cannot be subject, at consummation, to a commitment to be acquired by another person; and, legal title to the covered transaction cannot be sold, assigned, or otherwise transferred to another person before the end of the seasoning period. The proposal provides for two exemptions from this portfolio requirement in that the covered transaction may be sold, assigned, or otherwise transferred to another person pursuant to a capital restoration plan or prompt correction action, other action or instruction from a person acting as conservator, receiver, or bankruptcy trustee, or an order of the bank's state or federal regulator. The covered transaction may also be sold, assigned, or otherwise transferred pursuant to a merger or acquisition of the bank with another person.

The exemptions to the portfolio requirement apply not only to an initial sale, assignment, or other transfer by the originating creditor, but to subsequent sales, assignments, and other transfers as well. For example, assume Bank A originates a covered transaction that is not a QM at origination. Six months after consummation, the covered transaction is transferred to Bank B pursuant to merger of the two banks. The transfer does not violate the portfolio requirements of the proposed rule because the transfer is as a result of a merger. If Bank B sells the covered transaction before the end of the seasoning period, the covered transaction is not eligible to season into a QM under the Seasoned QM rules unless the sale falls within one of the two listed exemptions.

As outlined, a covered transaction sold pursuant to a capital restoration plan under a prompt corrective action before the end of the seasoning period does not violate the proposed rule's portfolio requirements. However, if the bank simply chose to sell the same covered transaction as one way to comply with general regulatory capital requirements in the absence of supervisory action or agreement, then the covered transaction cannot become a QM as a Seasoned QM, though it could qualify under another definition of QM.

Seasoning Period

The "seasoning period" means a period of 36 months beginning on the date on which the first periodic payment is due after consummation of the covered transaction, except that if there is a delinquency of 30-days or more at the end of the 36th month of the seasoning period, the seasoning period does not end until there is no delinquency. The seasoning period also does not include any period during which the consumer is in a temporary payment accommodation extended in connection with a disaster or pandemic-related national emergency, provided that during or at the end of the temporary payment accommodation there is a qualifying change or the customer cures the loan's delinquency under its original terms.

If during or at the end of the temporary payment accommodation in connection with a disaster or pandemic-related national emergency there is a qualifying change or the consumer cures the loan's delinquency under its original terms, the seasoning period consists of the period from the date on which the first periodic payment was due after consummation of the covered transaction to the beginning of the temporary payment accommodation and an additional period immediately after the temporary payment accommodation ends, which together must equal at least 36 months.

The proposed rule defines a "qualifying change" to mean an agreement that: (a) is entered into during or after a temporary payment accommodation in connection with a disaster or pandemic-related national emergency and must end any pre-existing delinquency on the loan obligation when the agreement takes effect; (b) the amount of interest charged over the full term of the loan does not increase as a result of the agreement; (c) there is no fee charged in connection with the agreement; and (d) all existing late fees, penalties, stop payment fees, or similar charges are promptly waived upon the consumer's acceptance of the agreement.

A "temporary payment accommodation in connection with a disaster or pandemic-related national emergency" is defined to mean temporary payment relief granted to a consumer due to financial hardship caused directly or indirectly by a presidentially declared emergency or major disaster under the Robert T. Stafford Disaster Relief and Emergency Assistance Act or a presidentially declared pandemic-related national emergency under the National Emergencies Act. Examples of temporary payment accommodations in connection with a disaster or pandemic-related national emergency include, but are not limited to, a trial loan modification plan, a temporary payment forbearance program, or a temporary repayment plan.

Consumer Payment Performance Requirements

The proposed rule also requires certain payment performances by the consumer. To be a Seasoned QM, the covered transaction must have no more than two delinquencies of 30 or more days and no delinquencies of 60 or more days at the end of the seasoning period. "Delinquency" is defined in the proposed rule to mean the failure to make a periodic payment (in one full payment or in two or more partial payments) sufficient to cover principal, interest, and, if applicable, escrow by the date the periodic payment is due

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under the terms of the legal obligation. Other amounts, such as any late fees, are not considered for this purpose. The "due date" is the date the payment is due under the terms of the legal obligation, without regard to whether the consumer is afforded a period after the due date to pay before being accessed a late fee.

Further, a periodic payment is 30 days delinquent when it is not paid before the due date of the following scheduled periodic payment. A periodic payment is 60 days delinquent if the consumer is more than 30 days delinquent on the first of two sequential scheduled periodic payments and does not make both sequential scheduled payments before the due date of the next scheduled periodic payment after the two sequential scheduled periodic payments. For example, assume a loan is consummated on October 15, 2022, that the consumer's periodic payment is due on the 1st of each month, and that the consumer timely made the first periodic payment due on December 1, 2022. For purposes of determining delinquency under the proposed rule, the consumer is 30 days delinquent if the consumer fails to make a payment (sufficient to cover the scheduled January 1, 2023 periodic payment of principal, interest, and, if applicable, escrow) before February 1, 2023. The consumer is 60 days delinquent if the consumer then fails to make two payments (sufficient to cover the scheduled January 1, 2023 and February 1, 2023 periodic payments of principal, interest, and, if applicable, escrow) before March 1, 2023.

For any given billing cycle for which a consumer's payment is less than the periodic payment due, a consumer is not delinquent as defined in the proposed rule if: (a) the servicer chooses not to treat the payment as delinquent for purposes of RESPA, Regulation X, if applicable; (b) the payment is deficient by $50 or less; and (c) there are not more than three such deficient payments treated as not delinquent during the seasoning period.

Conclusion

CFPB has proposed the creation of a Seasoned QM category as means to complement existing QM definitions and to help ensure access to responsible, affordable mortgage credit. A covered transaction would receive a safe harbor from ATR liability at the end of a 36-month seasoning period as a Seasoned QM if it satisfies certain product restrictions, points-and-fees limits, and underwriting requirements as outlined above.

CFPB has proposed that a final rule relating to the proposal would take effect on the same date as a final rule to amend the General QM definition. Comments regarding the proposed Seasoned QM category were initially due September 28, 2020; however, CFPB has since extended the comment period until October 1, 2020. WBA plans to file comments in general support of the proposal while offering several recommendations of change for CFPB to consider. Click here to view the proposal. ■

Regulatory Spotlight

Agencies Issue Final Rule to Implement Orderly Liquidation of Covered Broker-Dealer Provisions of Dodd-Frank Act.

The Federal Deposit Insurance Corporation (FDIC) and Securities and Exchange Commission (SEC) (collectively, the agencies) issued a final rule to implement provisions applicable to the orderly liquidation of covered brokers and dealers under Title II of the Dodd-Frank Act. Title II provides an alternative insolvency regime for the orderly liquidation of large financial companies that meet specified criteria. The final rule is effective **10/30/2020**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-08-31/pdf/2020-16468.pdf. *Federal Register*, Vol. 85, No. 169, 08/31/2020, 53645-53671.

Agencies Publish Semiannual Regulatory Agendas.

- The Bureau of Consumer Financial Protection (CFPB) published an agenda as part of the Spring 2020 Unified Agenda of Federal Regulatory and Deregulatory Actions. CFPB reasonably anticipates having the regulatory matters identified in the agenda under consideration during the period from **05/01/2020**, through **04/30/2021**. The next agenda will be published in fall 2020 and will update this agenda through fall 2021. The information in the agenda is current as of **03/05/2020**. The agenda may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-08-26/pdf/2020-16749.pdf. *Federal Register*, Vol. 85, No. 166, 08/26/2020, 52809-52814.

Wisconsin Bankers ASSOCIATION

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Compliance Journal

Special Focus

Exam Preparation Considerations

The COVID-19 pandemic has presented unique, unexpected, and ongoing difficulties, and Wisconsin banks have taken swift action by protecting their customers and employees, while meeting the financial needs of their communities. Banks have faced both operational and regulatory challenges, and over the past months, the banking agencies have issued guidance and rulemaking to provide tools and reduce burden. This new landscape leads to a unique examination environment, both in scope and in nature. In some cases, examination activity was paused at the start of the pandemic, but has recently resumed. This article provides a summary of agency guidance, as well as considerations and recommendations on preparing for upcoming exams considering the pandemic.

Background

On March 13 the president declared a national emergency, and on March 24, State shelter-in-place orders went into effect. During this time, the agencies issued guidance encouraging banks to work with customers affected by the pandemic. This guidance included statements that prudent efforts should not be subject to examiner criticism. More specifically, for example, the agencies stated in their March 22 guidance that they would not criticize financial institutions that mitigate credit risk through prudent actions consistent with safe and sound practices.

During this time, FDIC and OCC transitioned to conducting nearly all examinations remotely. DFI followed suit. FRB ceased all regular examination activity for institutions with less than $100 billion in assets and shifted its regulatory focus to monitoring and communicating. In the meantime, the agencies continued rulemaking and issuing guidance documents to support the industry. Links to COVID-related agency action are included at the end of the article, which includes establishment of credit and liquidity facilities, new allowances for certain capital methodologies, guidance on accounting for loan modifications, and reduced regulatory burden (for example: deletion of Reg D transaction limitations and waiver of appraisal requirements under certain circumstances, which will be used as scenarios later in the article).

Communities have been impacted by the pandemic to varying extents. Similarly, financial institutions have adapted in unexpected, unique ways. This results in operational challenges as banks look to assist their communities in a manner appropriate to the situation. It is important that banks remain mindful of increased risks, and be aware of examination expectations. In order to better prepare, this article presents some recommendations below.

Recommendations for Exam Preparation

Understandably, the unexpected complexities of the pandemic present unique compliance problems. Financial institutions may have made exceptions to policy, or undertaken actions they normally would not, but found appropriate, given the situation. It is important, then, that in such cases, the bank prepares appropriately for examination. Some specific considerations and examples are given below.

Overall Considerations

A good general starting point is to consider how the bank evaluated its potential risk, and how it responded to that risk. Meaning, when and how did bank measure the impact of the pandemic on its own operation, and its customers? On its capital and reserves? What steps did the bank take to manage that risk? For example: to earnings, capital adequacy, liquidity, and asset quality? What was known versus what remains uncertain? Examiners are likely to evaluate how a bank approached the pandemic in terms of making these considerations, questioning how bank prepared and ultimately, whether bank's response was tailored appropriately. For more specific examples consider:

- What risk management efforts did bank consider with respect to the impact of the pandemic on its customer base?
- Does bank do business with customers significantly affected by the pandemic in industries such as leisure, hotel, restaurant, or small business?

Overall Considerations (continued)

- What data did bank use to assess its risk then and now?
- For some loan customers, bank likely is aware of facts regarding the current financial situation of the customer (i.e., bank knows customer has closed its business with no plans to reopen), how did bank use that knowledge in its loan grading and risk analysis for the customer when the pandemic first hit and now?
- For loan customers where there are still too many unanswered questions (i.e., restaurant is permitted to operate at 25% capacity level for an undetermined amount of time), how does bank use that knowledge in its loan grading and risk analysis for the customer or pool of similarly situated customers?
- What considerations were made for forward looking impacts? Were capital resilience plans put into place?

These are all aspects that examiners are likely to consider, and a bank should be prepared with documentation to discuss its course of appropriate action.

Loan Modifications and Deferrals

Many financial institutions have worked with borrowers experiencing financial hardship by providing options for loan modifications and deferrals. The agencies have recognized this, and stated that they view loan modification programs as positive actions that can mitigate adverse effects on borrowers due to the pandemic. Financial institutions should consider:

- How did bank work with a customer and tailor the accommodation to the situation? (for example: restaurant business experiencing hardship? Customer laid off? Furloughed?)
- How did bank evaluate and mitigate risk?
- What monitoring is in place?
- Will bank re-evaluate the loan? When? Is there a plan in place with the customer if future accommodations are necessary?
- How were these loans graded?
- If loan payments were forborne, what are repayment options when forbearance period ends? Will bank follow CFPB's newest mitigation option regarding forbearance? What compliance-related procedures need be added to existing procedures, or do new procedures need be created?

Deposit-Related Considerations

Financial institutions should also consider any changes made to deposit operations due to the pandemic. Changes in lobby hours or access, staffing, and customer needs may have resulted in lapses in compliance or exceptions to typical policy. Remote engagements may have resulted in delayed or missed disclosures, or unique account opening procedures. For example, as a result of the Regulation D changes, a bank may have suspended (temporarily or permanently), transaction limitations on savings accounts. As something that was immediately available as a tool to assist customers, many banks may have implemented without additional thought, but there is more to consider:

- Were disclosures updated appropriately?
- Was any notice provided to customers?
- Is the change temporary? If so, has bank made plans for re-implementation, including advanced notice to its customers?

If the institution has identified that a compliance-related error occurred, it is best to both identify the error and be prepared to explain how the error was remedied, including any reimbursements paid to customers affected by the error. The proactive efforts by the bank should lessen the impact of the compliance error as a one-time inadvertent error which resulted due to the impact of the pandemic and mitigation efforts rather than a systemic compliance violation.

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Review Previous Risk Analysis

As mentioned above, the pace at which financial institutions have had to adopt to the pandemic was unprecedented. Financial institutions had little time to react to state- and local-level mitigation efforts. However, now that the industry is seven-months into the pandemic, financial institutions are reminded to consider review of how temporary and permanent operational changes made as a result of the pandemic could change a previously set risk level for a given procedure or policy. A review prior to examination will better prepare the institution for examiner questions related to risk. For example, if the bank's normal practice is to open deposit accounts in person and now the practice has become a procedure of opening deposit accounts exclusively online via bank's website, has bank modified its risk analysis of the online activity impact on the bank. Regarding the Reg D changes mentioned above, if bank now allows for unlimited withdrawals from savings deposit accounts, what impact did that change have in bank's liquidity or other related risk concerns? Has the bank adjusted its risk analysis for either activity?

Reliance Upon Agency Guidance

As discussed above, the agencies have issued numerous rules and guidance documents throughout the pandemic. Where a financial institution may have relied upon agency guidance, it should refer to the proper document and fit its actions within the appropriate context. For example, the agencies issued an interim, now final, rule deferring the requirement to obtain an appraisal or evaluation for up to 120 days following closing, excluding certain transactions, and under certain conditions. If a financial institution relied upon this rule, it should document all steps taken in accordance with the requirements. For consideration:

- Does bank have evidence prepared that the loan is not for acquisition, development, and construction of real estate?
- What efforts did bank make to obtain an appraisal or evaluation?
- How did bank otherwise develop a well-informed estimate of the collateral value of the property?
- Did bank adhere to internal underwriting standards for creditworthiness and ability to repay?
- What other risk-mitigation steps were taken?

Safety and Soundness Considerations

In a recent panel discussion with FRB, FDIC, OCC, and DFI Safety and Soundness Risk Field Supervisors, the examiners shared their exam focus areas and things that banks should consider as examinations return to a more routine schedule. The examiners all identified cybersecurity and information technology (IT) concerns as one of their top risk concerns given the fact the industry has been working remotely. Additionally, banks should be certain they are attending to increased fraud activity. Banks should be prepared to share strengths in each of the identified areas, and if problems arose, be prepared to explain how the bank addressed and mitigated the situation to avoid any future repeat of the cybersecurity or IT issue.

Another area of concern is bank's management of loan portfolios. The examiners all agree that loan analysis and calculating accurate loan projections can be difficult given the current economic uncertainty as caused by the pandemic. However, the examiners encouraged the performance of additional analysis. More specifically, they stated that an historical analysis can be helpful but be mindful of what may impact a particular borrower given the uniqueness of the borrower. If projections are used for loan analysis, examiners stated they will be looking for supporting documentation regarding the bank's analysis.

To help illustrate just how individualized an analysis likely need become, OCC gave a trucking company example: while the customer's current cash flow is negative given recent travel restrictions and reduced schedules for transporting goods, when looking further at projections the customer may well have an overall more positive picture due to upcoming trucking contracts as travel restrictions ease, more areas reopen, and the holiday season begins – thus making the transportation of goods more necessary and projections realistically positive. On the flip side, a business in the hospitality-related industry. A reliance on an historical analysis will likely not accurately reflect the current status of travel in the area. Historically, this customer likely had high holiday and event activities resulting in an overall positive end-of-year analysis. However, projections for end of this year need be realistic. As travel restrictions lift in some areas, hotels and conference occupancy rates will realistically still not be up to pre-pandemic or past holiday levels given the general populations' concerns over travel. Full capacity levels during last year's end-of-year is likely not be same level of activity for this year's end-of-year.

Communication with Examiners

Amidst planning for an upcoming examination, financial institutions should not hesitate to have robust conversations with lead examiners and field examiner supervisors to explain how the pandemic has specifically impacted the institution. Such conversation will help set exam scope and focus. Regulators have reported exams are likely to remain remote until end-of-year; this format will require exam information to be shared electronically. If sharing of information electronically is difficult due to not all files being

Special Focus

Communication with examiners (continued)

converted into electronic files, examiners should be alerted to that fact so other accommodations can be arranged without adding unnecessary or duplicative efforts for the bank. Additionally, key staff may still be working remotely which may impact exam scheduling. This is especially critical for staff that may have connectivity or broadband limitations when trying to participate in electronic meetings. Banks should discuss exam schedules to ensure necessary bank staff are available during the exam and have access necessary to effectively participate and interact with the examination team. Also, don't be afraid to ask questions as to an examiner's rationale and be prepared to further explain bank managements' decisions and reasoning for actions taken during the pandemic.

Conclusion

This article is designed to help financial institutions prepare for upcoming examinations. While it contains general considerations, and some specific examples, the impact of the pandemic will be different from institution to institution and from affected borrower to affected borrower. Furthermore, each institution's exam response will vary. As such, preparation should be tailored accordingly. WBA anticipates that examiners will be mindful of the varying levels of impact and response, but the more prepared a financial institution is, the more it can assist in creating a transparent examination process.

Resources for COVID-related agency activity:

OCC: https://www.occ.gov/topics/supervision-and-examination/bank-operations/covid-19-information/convid-19-info-index.html

FDIC: https://www.fdic.gov/coronavirus/index.html

FRB: https://www.federalreserve.gov/covid-19.htm

Webinar: Update on FRB's supervisory posture for small banks as examinations resume:
https://bsr.stlouisfed.org/askthefed/Home/ArchiveCall/273 ■

Regulatory Spotlight

Agencies Issue Final Rule to Correct Counterparty Credit Risk Capital Rule.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the agencies) issued a final rule to make technical corrections to certain provisions of the capital rule related to the standardized approach for counterparty credit risk (SA-CCR), which is used to calculate the exposure amount of derivative contracts and was adopted in a final rule published on **01/24/2020**. The amendatory text of the SA-CCR final rule did not accurately reflect the treatment described in the supplementary information section of the SA-CCR final rule for the items described in the January final rule. This final rule corrects the agencies' capital rule consistent with the supplementary information section of the SA-CCR final rule. The agencies also made corrections to certain cross-references within the capital rule that are no longer accurate as of the effective date of the SA-CCR final rule. The final rule is effective **09/17/2020**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-09-17/pdf/2020-17744.pdf. *Federal Register*, Vol. 85, No. 181, 09/17/2020, 57956-57964.

Agencies Issue Final Rule to Delay Estimated Impact of Implementing CECL.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) (collectively, the agencies) issued a final rule that delays the estimated impact on regulatory capital stemming from the implementation of Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses, Topic 326, Measurement of Credit Losses on Financial Instruments (CECL)*. The final rule provides banking organizations that implement CECL during the 2020 calendar year the option to delay for two years an estimate of CECL's effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period. The agencies are providing the relief to allow banking organizations to better focus on supporting lending to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of the coronavirus disease 2019, while also maintaining the quality of regulatory capital. The final rule is consistent with the interim final rule published in the *Federal Register* on **03/31/2020**, with certain clarifications and minor adjustments in response to comments related to the mechanics of the transition and the eligibility criteria for applying the transition. The final rule is effective **09/30/2020**. The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2020-09-30/pdf/2020-19782.pdf. *Federal Register*, Vol. 85, No. 190, 09/30/2020, 61577-61594.

Wisconsin Bankers ASSOCIATION

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Special Focus

SBA Guidance for Change of Ownership Involving a PPP Borrower

As banks work through the PPP forgiveness process with their borrowers, situations may arise involving a change of ownership as a result of mergers, acquisitions, or other sale of business assets. Given the certifications made for PPP funds, the requirements of the forgiveness process, and the variables involved in such a sale, this situation can present difficulty for lenders.

On October 2, 2020 the Small Business Administration (SBA) issued a procedural notice to provide information concerning the required procedures for changes of ownership of an entity that has received PPP funds.

SBA Procedural Notice

For purposes of the PPP, SBA considers a "change of ownership" to have occurred when:

1. At least 20 percent of the common stock or other ownership interest of a PPP borrower (including a publicly traded entity) is sold or otherwise transferred, whether in one or more transactions, including to an affiliate or an existing owner of the entity,

2. The PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured by fair market value), whether in one or more transactions, or

3. A PPP borrower is merged with or into another entity.

The procedural notice clarifies that regardless of any change of ownership, the PPP borrower remains responsible for:

1. Performance of all obligations under the PPP loan,

2. The certifications made in connection with the PPP loan application, including the certification of economic necessity, and

3. Compliance with all other applicable PPP requirements.

Additionally, the PPP borrower remains responsible for obtaining, preparing, and retaining all required PPP forms and supporting documentation and providing those forms and supporting documentation to the PPP lender or lender servicing the PPP loan or to SBA upon request.

Prior to the closing of any change of ownership transaction, the PPP borrower must notify the PPP lender in writing of the contemplated transaction and provide the PPP lender with a copy of the proposed agreements or other documents that would effectuate the proposed transaction.

There are different procedures depending on the circumstances of the change of ownership, as set forth below. In all cases, the lender is required to continue submitting the monthly 1502 reports until the PPP loan is fully satisfied.

1. **The PPP Note is fully satisfied.** There are no restrictions on a change of ownership if, prior to closing the sale or transfer, the PPP borrower has:

a. Repaid the PPP note in full; or

b. Completed the loan forgiveness process in accordance with the PPP requirements and:

i. SBA has remitted funds to the PPP lender in full satisfaction of the PPP note; or

ii. The PPP borrower has repaid any remaining balance on the PPP loan.

2. **The PPP Note is not fully satisfied.** If the PPP note is not fully satisfied prior to closing the sale or transfer, the following applies:

a. *Cases in which SBA prior approval is not required.* If the following conditions are met for (i) a change of ownership structured as a sale or other transfer of common stock or other ownership interest or as a merger; or (ii) a change of ownership structured as an asset sale, the PPP lender may approve the change of ownership and SBA's prior approval is not required:

i. *Change of ownership is structured as a sale or other transfer of common stock or other ownership interest or as a merger.* An individual or entity may sell or otherwise transfer common stock or other ownership interest in a PPP borrower without the prior approval of SBA only if:

a) The sale or other transfer is of 50 percent or less of the common stock or other ownership interest of the PPP borrower; or

b) The PPP borrower completes a forgiveness application reflecting its use of all of the PPP loan proceeds and submits it, together with any required supporting documentation, to the PPP lender, and an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan. After the forgiveness process (including any appeal of SBA's decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest.

In any of the circumstances described in a) or b) above, the procedures described in paragraph #2.c. below must also be followed.

ii. *Change of ownership is structured as an asset sale.* A PPP borrower may sell 50 percent or more of its assets (measured by fair market value) without the prior approval of SBA only if the PPP borrower completes a forgiveness application reflecting its use of all of the PPP loan proceeds and submits it, together with any required supporting documentation, to the PPP lender, and an interest-bearing escrow account controlled by the PPP lender is established with funds equal to the outstanding balance of the PPP loan. After the forgiveness process (including any appeal of SBA's decision) is completed, the escrow funds must be disbursed first to repay any remaining PPP loan balance plus interest. The PPP lender must notify the appropriate SBA Loan Servicing Center of the location of, and the amount of funds in, the escrow account *within 5 business days* of completion of the transaction.

b. *Cases in which SBA prior approval is required.* If a change of ownership of a PPP borrower does not meet the conditions in paragraph #2.a. above, prior SBA approval of the change of ownership is required and the PPP lender may not unilaterally approve the change of ownership.

To obtain SBA's prior approval of requests for changes of ownership, the PPP lender must submit the request to the appropriate SBA Loan Servicing Center. The request must include:

i. The reason that the PPP borrower cannot fully satisfy the PPP Note as described in paragraph #1 above or escrow funds as described in paragraph #2.a above;

ii. The details of the requested transaction;

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iii. A copy of the executed PPP Note;

iv. Any letter of intent and the purchase or sale agreement setting forth the responsibilities of the PPP borrower, seller (if different from the PPP borrower), and buyer;

v. Disclosure of whether the buyer has an existing PPP loan and, if so, the SBA loan number; and

vi. A list of all owners of 20 percent or more of the purchasing entity.

SBA may require additional risk mitigation measures as a condition of its approval of the transaction, if deemed necessary. SBA approval of any change in ownership involving the sale or 50 percent or more of the assets (measured by fair market value) of a PPP borrower will be conditioned on the purchasing entity assuming all of the PPP borrower's obligations under the PPP loan, including responsibility for compliance with the PPP loan terms. In such cases, creditors should review language of the sale or purchase agreement, as the agreements must include appropriate language regarding the assumption of the PPP borrower's obligations under the PPP loan by the purchasing person or entity, or a separate assumption agreement must be submitted to SBA. SBA will review and provide a determination within 60 calendar days of receipt of a complete request.

c. *For all sales or other transfers of common stock or other ownership interest or mergers, whether or not the sale requires SBA's prior approval*. As mentioned above, regardless of any change of ownership, the PPP borrower (and, in the event of a merger of the PPP borrower into another entity, the successor to the PPP borrower) will remain subject to all obligations under the PPP loan. In addition, if the new owner(s) use PPP funds for unauthorized purposes, SBA will have recourse against the owner(s) for the unauthorized use.

If any of the new owners or the successor arising from such a transaction has a separate PPP loan, then, following consummation of the transaction: (1) in the case of a purchase or other transfer of common stock or other ownership interest, the PPP borrower and the new owner(s) are responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements by each PPP borrower, and (2) in the case of a merger, the successor is responsible for segregating and delineating PPP funds and expenses and providing documentation to demonstrate compliance with PPP requirements with respect to both PPP loans.

The PPP lender must notify the appropriate SBA Loan Servicing Center, *within 5 business days* of completion of the transaction, of the: identity of the new owner(s) of the common stock or other ownership interest, new owner(s)' ownership percentage(s), the taxpayer identification number(s) for any owner(s) holding 20 percent or more of the equity in the business, and the location of, and the amount of funds in, the escrow account under the control of the PPP lender, if an escrow account is required.

Lastly, the procedural notice reminds lenders that if a PPP loan of a PPP borrower associated with a change of ownership transaction was pledged by the PPP lender to secure a loan under the Federal Reserve's Paycheck Protection Program Liquidity Facility (PPPLF), the lender must comply with any notification or other requirements of the PPPLF.

Conclusion

If a lender learns a PPP borrower may be selling the business during the period when their PPP loan is outstanding, it is important to be aware of SBA's expectations and the lender should be communicating with the borrower to fully understand the sale as it develops. Ideally, the sale would be postponed, but that may not always be an option. Lenders should consider SBA's procedural notice, as well as some practical considerations, for example, whether an escrow account need be established, whether certifications will be made by the buyer, and what is contemplated in the sale or purchase agreement (*i.e.*, does the agreement include appropriate language regarding the assumption of the PPP borrower's obligations under the PPP loan by the purchasing person or entity). Lenders will want to work closely with any PPP borrowers going through a change in ownership to ensure any applicable requirements are met, including providing required information to the SBA Loan Servicing Center within 5 business days of the completion of the transaction.

SBA's procedural notice can be found here: https://www.sba.gov/sites/default/files/2020-10/5000-20057-508.pdf ■

deferral or forbearance included escrow payments. Even if it did not, financial distress caused by the pandemic may have resulted in more escrow shortages and deficiencies than typical. Banks should consider how they are monitoring loans for payments, and accounting for expected, and unexpected shortages. Specific attention may need to be paid to escrow balances for loans in deferral, forbearance, or modification. Banks should identify loans that will be short, and determine how the deficiency will be handled, with the above considerations in mind.

Q6: What is the escrow rate for 2021, as set by section 138.052 Wis. Stat?

A6: The Wisconsin Department of Financial Institutions, Division of Banking, has calculated the interest rate required to be paid on escrow accounts for residential mortgage loans subject to Wisconsin Statute section 138.052(5) to be **0.11%** for 2021. The interest rate shall remain in effect through December 31, 2021.

Q7: Does sec. 138.052 Wis. Stat. require Wisconsin banks to pay interest on escrow accounts?

A7: Not for loans originated after April 18, 2018. 2017 Wisconsin Act 340 eliminated the requirement that a financial institution pay interest on escrow accounts for residential mortgage loans originated on or after the effective date of Act 340. Thus, a Wisconsin financial institution is not required by law to pay interest on any escrow account maintained in association with a loan originated on or after April 18, 2018.

Wisconsin Statute section 138.052 previously required financial institutions to pay interest on the balance on any required escrow accounts. As discussed above, section 138.052 applies to consumer-purpose loans secured by a first lien or first lien equivalent in a 1-4 family dwelling that is used as the borrower's principal residence. Banks must continue to pay interest on escrow accounts they required prior to the effective date of Act 340. However, for any escrow account associated with a loan originated after the effective date of Act 340, section 138.052 no longer requires payment of interest. A bank should also consider the terms of its contract as to whether any payment of interest is part of the agreement.

Q8: Bank is closing loan in December for which bank will require escrow for the payment of taxes. The first mortgage payment will be in February. Can bank escrow for 2020 taxes to be paid in 2021?

A8. No. RESPA's escrow collection rules are prospective in nature. Bank should only collect for 2021 taxes to be paid either in December 2021 in a lump sum (with borrower's permission as outlined above) or in installments. Bank should not collect for anything between December 1 and 31st because nothing is owing during that time as the bank should only be collecting for 2021 taxes. Bank should not be collecting for 2020 taxes for payment in 2021. Borrower should be on his/her own to pay 2020 taxes. ■

CFPB Issues Revised General QM and New Seasonal QM Rules

Early this month, the Bureau of Consumer Financial Protection (CFPB) released two final rules regarding the rules affecting qualified mortgages (QM) under Regulation Z. This article is a highlight of the key provisions of the two new rules.

Background and Rationale for Revised General QM Rule

Under Regulation Z, the Ability-to-Repay/Qualified Mortgage Rule (ATR/QM Rule) requires a creditor to make a reasonable, good faith determination of a consumer's ability to repay a residential mortgage loan according to its terms. Loans that meet the ATR/QM Rule's requirements for QMs obtain certain protections from liability. The ATR/QM Rule defines several categories of QMs, including the General QM category.

General QMs must comply with the ATR/QM Rule's prohibitions on certain loan features, its points-and-fees limits, and its underwriting requirements. For General QMs, the consumer's debt-to-income (DTI) ratio must not exceed 43 percent. The ATR/QM Rule requires that creditors must calculate, consider, and verify debt and income for purposes of determining the consumer's DTI ratio using the standards contained in appendix Q of Regulation Z.

The primary reason behind why CFPB revised the General QM rule is because of conditions related to another QM category referred to as the Temporary QM. The Temporary category of QMs defined in the ATR/QM Rule consists of mortgages that (1) comply with the same loan-feature prohibitions and points-and-fees limits as General QMs and (2) are eligible to be purchased or guaranteed by the GSEs (*i.e.*, Fannie Mae and Freddie Mac) while under the conservatorship of the Federal Housing Finance Agency (FHFA).

Unlike for General QMs, the ATR/QM Rule does not prescribe a DTI limit for Temporary GSE QMs. Thus, a loan can qualify as a Temporary GSE QM even if the consumer's DTI ratio exceeds 43 percent, as long as the loan is eligible to be purchased or guaranteed by either of the GSEs and satisfies the other Temporary GSE QM requirements. In addition, for Temporary GSE QMs, the ATR/QM Rule does not require creditors to use appendix Q to determine the consumer's income, debt, or DTI ratio.

When first promulgated in 2013, the Temporary GSE QM loan definition was set to expire with respect to each GSE when that GSE ceased to operate under federal conservatorship or on January 10, 2021, whichever comes first. The GSEs are currently under federal conservatorship. Today, Temporary GSE QM originations continue to represent a large share of the residential mortgage loan market. Without changes to the General QM loan definition, a significant number of Temporary GSE QMs would not be made or would be made at higher prices when the Temporary GSE QM loan definition expires, or after January 2021. The affected loans would include loans for which the consumer's DTI ratio is above 43 percent or the creditor's method of documenting and verifying income or debt is incompatible with appendix Q.

On October 20, 2020, CFPB issued a final rule to amend Regulation Z to replace the January 10, 2021, sunset date of the Temporary GSE QM loan definition with a provision stating that the Temporary GSE QM loan definition will be available only for covered transactions for which the creditor receives the consumer's application before the mandatory compliance date of final amendments to the General QM loan definition in Reg Z. The extension of the sunset date was meant to help ensure consumers remain able to have access to mortgage loan products with as little disruption to the marketplace as possible.

Revised General QM

In its December final rule, CFPB amended Regulation Z to replace the existing General QM loan definition with its 43 percent DTI limit with a price-based General QM loan definition. Under the final rule, a loan meets the General QM loan definition in section 1026.43(e)(2) only if the annual percentage rate (APR) exceeds the average prime offer rate (APOR) for a comparable transaction by less than 2.25 percentage points as of the date the interest rate is set. The final rule provides higher thresholds for loans with smaller loan amounts, for certain manufactured housing loans, and for subordinate-lien transactions.

The thresholds set forth in the General QM Final Rule are:

- For a first-lien covered transaction with a loan amount greater than or equal to $110,260, 2.25 percentage points;
- For a first-lien covered transaction with a loan amount greater than or equal to $66,156 but less than $110,260, 3.5 percentage points;
- For a first-lien covered transaction with a loan amount less than $66,156, 6.5 percentage points;
- For a covered transaction secured by a manufactured home with a loan amount less than $110,260, 6.5 percentage points;
- For a covered transaction secured by a manufactured home with a loan amount equal to or greater than $110,260, 2.25 percentage points;
- For a subordinate-lien covered transaction with a loan amount greater than or equal to $66,156, 3.5 percentage points; and
- For a subordinate-lien covered transaction with a loan amount less than $66,156, 6.5 percentage points.

If a loan's interest rate may or will change in the first five years after the date on which the first regular periodic payment will be due, the creditor must treat the highest interest rate that may apply during that five years as the loan's interest rate for the entire loan term when determining the APR for purposes of the thresholds. See the final rule for additional information on determining the APR, the APOR, and the applicable threshold.

The final rule requires that the creditor consider the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan, debt obligations, alimony, child support, and DTI ratio or residual income. A creditor must maintain written policies and procedures for how it will take into account these factors.

A creditor must also retain documentation showing how it met the ability-to-repay determination, including how it applied its policies and procedures, in order to meet the requirement to consider and thereby meet the requirements for a QM under the General QM category. The documentation may include, for example, an underwriter worksheet or a final automated underwriting system certification, in combination with the creditor's applicable underwriting standards and any applicable exceptions described in its policies and procedures, that shows how these required factors were taken into account in the creditor's ability-to-repay determination.

In addition to removing the 43 percent DTI ratio limit, the final rule removes appendix Q. A creditor, however, is still required to verify the consumer's current or reasonably expected income or assets other than the value of the dwelling (including any real property attached to the dwelling) that secures the loan and the consumer's current debt obligations, alimony, and child support. A creditor is only required to verify the income or assets the creditor relies on to evaluate the consumer's repayment ability. For example, if a consumer's application states that the consumer earns a salary and is paid an annual bonus and the creditor relies on only the consumer's salary to evaluate the consumer's repayment ability, the creditor need verify only the salary.

The final rule provides that a creditor may verify a consumer's income using an Internal Revenue Service (IRS) tax-return transcript, which summarizes the information in a consumer's filed tax return, another record that provides reasonably reliable evidence of the consumer's income, or both. A creditor may obtain a copy of a tax-return transcript or a filed tax return directly from the consumer or from a service provider. A creditor need not obtain the copy directly from the IRS or other taxing authority.

To assist with the verification process in light of the removal of appendix Q, CFPB included in the final rule several sources that may be used by creditors. In particular, a creditor can comply with Regulations Z's revised verification requirement if it complies with verification standards in one or more of the following manuals:

- Chapters B3-3 through B3-6 of the Fannie Mae Single-Family Selling Guide, published June 3, 2020;
- Sections 5102 through 5500 of the Freddie Mac Single-Family Seller/Servicer Guide, published June 10, 2020;
- Sections II.A.1 and II.A.4-5 of the Federal Housing Administration's Single-Family Housing Policy Handbook, issued October 24, 2019;
- Chapter 4 of the U.S. Department of Veterans Affairs' (VA) Lenders Handbook, revised February 22, 2019;
- Chapter 4 of the U.S. Department of Agriculture's (USDA) Field Office Handbook for the Direct Single-Family Housing Program, revised March 15, 2019; and
- Chapters 9 through 11 of the USDA's Handbook for the Single-Family Guaranteed Loan Program, revised March 19, 2020.

Under the General QM final rule, to qualify for General QM treatment, a loan still cannot have negative amortization, interest-only, balloon-payment features, a term that exceeds 30 years, or points and fees that exceed specified limits. The final rule does not affect QM definitions that apply to Federal Housing Administration, U.S. Department of Veterans Affairs, U.S. Department of Agriculture, or Rural Housing Service loans.

Seasoned QM

CFPB has also created a new category of QMs—the Seasoned QM. A Seasoned QM will receive a safe harbor from liability under the ATR/QM Rule if certain product restrictions and underwriting requirements are met. A loan made by any creditor, regardless of size, is eligible to become a Seasoned QM if at the end of the seasoning period it meets the requirements in the Seasoned QM final rule.

To qualify as a Seasoned QM, the loan must: be secured by a first lien, have a fixed rate with regular, substantially equal periodic payments that fully amortize the loan (*i.e.*, no balloon payments), have a term that does not exceed thirty (30) years, and not be a high-cost mortgage loan as defined by Regulation Z section 1026.32(a). The loan must also meet the points and fees limits applicable to the ATR/QM rule.

In review of the consumer's DTI ratio or residual income, income or assets (other than the value of the dwelling), and debts, a creditor is required to apply the same underwriting consider and verify rules of the revised General QM rule as discussed earlier in this article to underwriting a Seasoned QM loan.

The final rule also contains performance standards that must be met by the consumer for the loan to qualify as a Seasoned QM at the end of its seasoning period. In particular, the loan cannot have more than two delinquencies of thirty (30) days and cannot have a delinquency of sixty (60) days or more at the end of the seasoning period. The rule further discusses what it considered a delinquency.

A Seasoned QM must also be held by the creditor in its portfolio until the end of a thirty-six (36) month "seasoning" period. The final rule further clarifies that in order for the loan to be considered held in a creditor's portfolio, the loan cannot be subject, at consummation, to a commitment to be acquired by another person, and legal title to the loan cannot be sold, assigned or otherwise transferred before the end of the seasoning period. The final rule allows for an exception to that general requirement if the loan need be sold, assigned, or transferred pursuant to a capital restoration or prompt correction action plan, or under conservatorship, receivership, or bankruptcy actions, or pursuant to an order or agreement by a creditor's state or federal regulator. The final rule also allows for a transfer pursuant to a merger or acquisition of the creditor; see the final rule for further details.

The 36-month seasoning period begins on the date on which the first periodic payment is due after consummation. The seasoning period may be extended in two circumstances. First, the seasoning period may be extended if there is a delinquency of thirty (30) days or more at the end of the final month of the seasoning period. The seasoning period is extended until there is no delinquency. Second, the seasoning period will be extended if the consumer is under a temporary payment accommodation in connection with a disaster or pandemic-related national emergency. In such circumstance, the time spent in a temporary payment accommodation extended for that unique purpose does not count towards the seasoning period. The seasoning period can only resume after the temporary payment accommodation if any delinquency is cured either pursuant to the loan's original terms or through a qualifying change.

Conclusion

CFPB has revised the General QM category to better accommodate the sunset of the Temporary GSE category. The revised General QM category no longer has a 43 percent DTI ratio requirement and creditors have greater flexibility in underwriting as appendix Q has been removed as the sole means to consider and verify consumers' assets, income, and debts. CFPB also established a new Seasoned QM which allows creditors to obtain QM status and therefore receive safe harbor from liability under the ATR/QM Rule after a seasoning period if certain product restrictions, underwriting requirements, and performance standards are met.

The General QM rule is effective sixty (60) days after publication of the rule in the *Federal Register*. Mandatory compliance with the rule is **July 1, 2021**. Creditors have the option to comply with the revised General QM definition for covered transactions for which creditors receive an application on or after the effective date based upon publication, and before the July mandatory compliance date. The Seasoned QM rule is effective sixty (60) days after publication of the rule in the *Federal Register*.

The General QM final rule may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_atr-qm-general-qm-final-rule_2020-12.pdf

The Seasoned QM final rule may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_atr-qm-seasoned-qm-final-rule_2020-12.pdf

A red-line markup of Regulation Z may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_atr-qm-final-rule-amendments_unofficial-redline_2020-12.pdf ■

Wisconsin Bankers Association

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Compliance Journal

Special Focus

Year-end Frequently Asked Escrow Questions

While there has not been a recent significant change to escrow requirements, it is WBA's understanding that many banks pay taxes from escrow by December 20th every year. Around this time, many questions arise as to State and Federal requirements regarding escrow accounts. Furthermore, given the impacts of the COVID-19 pandemic, many borrowers may have been, or currently are, in deferral or forbearance, resulting in insufficient escrow balances. This article presents several questions and answers to refresh banks on relevant requirements, and important considerations, regarding escrow accounts both with respect to the pandemic, and more generally.

Q1: Does Wisconsin have rules regarding disbursements from tax escrows?

A1: Yes. Wis. Stat. section 138.052(5m) governs escrow accounts required to be maintained to pay taxes or insurance in connection with consumer-purpose loans secured by a first lien real estate mortgage or equivalent security interest in the borrower's principal dwelling. For example, the requirement applies to covered purchase money, refinance, and home equity transactions but does not apply to loans that are business or agricultural purpose, or manufactured home transactions. It also does not apply to voluntary escrow accounts. If a bank maintains a voluntary escrow account, it should ensure it has adequate documentation to evidence that fact.

For covered loans, banks must provide an escrow notice before closing giving the borrower options regarding how the bank will make payments from the amount escrowed:

1. Escrow agent sends a check by December 20 to the borrower for the amount held in escrow for the payment of property taxes made payable to the borrower or to the borrower and the taxing authority.
2. Escrow agent pays the property taxes by December 31 if the escrow agent has received a tax statement for the property by December 20.
3. Escrow agent pays the property taxes when due.

This notice is not required under section 138.052(5m) if the escrow agent's practice is to pay the borrower the amount held in escrow for the payment of property taxes by December 20, or to send a check in the amount of the funds held in escrow for the payment of property taxes, made payable to the borrower and taxing authority.

Regardless of whether a notice under state law may not be required, banks are reminded that a voluntary agreement is still required under the Real Estate Settlement Procedures Act (RESPA) to pay property taxes annually as permitted under Wis. Stat. section 138.052(5m). See the discussion below regarding the interconnection between state and federal law.

Q2: Does RESPA have rules regarding disbursements from tax escrows?

A2: Yes. RESPA section 1024.17(k) prescribes rules that apply to escrow accounts established in connection with RESPA-covered loans to pay taxes, insurance, or other charges. If the terms of the loan require the borrower to make payments to an escrow account, the bank must make disbursements in a timely manner. A timely manner means payment by the disbursement date, so long as the loan account is not more than 30 days overdue.

If a taxing authority offers a bank a choice between annual and installment disbursements, RESPA includes additional requirements. Generally, disbursements must be made on an installment basis depending on whether the taxing authority offers a discount, or charges additional fees, for installment disbursements. In Wisconsin, where taxes may be paid in annual or installment payments, and the taxing authority does not offer a discount for payments on an annual basis nor does it impose any additional charge or fee for installment payments, the bank must make disbursements on an installment basis, unless the bank and borrower agree to another disbursement alternative.

Most property taxes in Wisconsin may be payable in two installments. If the first installment is paid by January 31st, the second installment may be paid by July 31st. Because no discount is available for making annual payments, and no penalty is imposed for making installment payments, RESPA requires property taxes payable in this manner to be disbursed on an installment basis, unless the borrower voluntarily agrees, in writing, to an annual disbursement.

Q3: How do the requirements under Wis. Stat. section 138.052(5m) and RESPA section 1024.17 work together?

A3: RESPA preempts State law only to the extent of any inconsistency. Generally, escrows governed by section 138.052(5m) must also comply with RESPA, and banks must disburse tax escrows in installments, or as otherwise agreed to by the borrower. Thus, banks will want to consider their written agreement as to the borrower's choice of disbursement methods, and as discussed in Q1 above, a bank may pay by December 20th by check.

As RESPA requires taxes to be disbursed in installments, and State law allows more flexibility in how taxes are paid, in order for a bank to disburse money from a required escrow account, annually under the section 138.052(5m) December 20th method, RESPA requires the customer's voluntary agreement of that option. And, while notice under section 138.052(5m) may not be required, RESPA still requires the customer's voluntary agreement to pay by December 20th. See the discussion in Q2. FIPCO's WBA Tax Escrow Option Election form meets the requirements under Wis. Stat. 138.052(5m) and also serves as the voluntary agreement to disburse property taxes out of escrow in any method other than installments to comply with RESPA.

Q4: What if a deficiency occurs before disbursement?

A4: As discussed in Q2, RESPA generally requires the bank to disburse funds in a timely manner. If a deficiency exists, the bank must still cover the amount due. Upon advancing the funds, the bank may seek repayment from the borrower after performing an escrow account analysis.

If the deficiency is less than one month's escrow account payment, then the bank:

1. May allow the deficiency to exist and do nothing to change it;
2. May require the borrower to repay the deficiency within 30 days; or
3. May require the borrower to repay the deficiency in 2 or more equal monthly payments.

If the deficiency is greater than or equal to 1 month's escrow payment, the bank may allow the deficiency to exist and do nothing to change it or may require the borrower to repay the deficiency in two or more equal monthly payments.

If the borrower is not current, then the bank may recover the deficiency pursuant to the terms of the mortgage loan documents. For example, language within the WBA 428 Real Estate Mortgage states that if the escrowed funds held by bank are not sufficient to pay the escrow account items when due, bank may notify consumer in writing, and consumer shall pay bank the amount necessary to make up the deficiency in a manner described by bank or as otherwise required by applicable law.

Furthermore, for loans that are not covered by RESPA (*i.e.*, the escrow account is not required), the bank will need to determine how the deficiency will be covered, either by the borrower, or the bank, pursuant to the terms of its agreement.

Q5: How does a payment deferral or forbearance affect escrow considerations?

A5: As a result of the pandemic, bank may have deferred or forborne payments for some of its borrowers. Bank should consider its deferral and forbearance agreements to confirm whether this

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deferral or forbearance included escrow payments. Even if it did not, financial distress caused by the pandemic may have resulted in more escrow shortages and deficiencies than typical. Banks should consider how they are monitoring loans for payments, and accounting for expected, and unexpected shortages. Specific attention may need to be paid to escrow balances for loans in deferral, forbearance, or modification. Banks should identify loans that will be short, and determine how the deficiency will be handled, with the above considerations in mind.

Q6: What is the escrow rate for 2021, as set by section 138.052 Wis. Stat?

A6: The Wisconsin Department of Financial Institutions, Division of Banking, has calculated the interest rate required to be paid on escrow accounts for residential mortgage loans subject to Wisconsin Statute section 138.052(5) to be **0.11%** for 2021. The interest rate shall remain in effect through December 31, 2021.

Q7: Does sec. 138.052 Wis. Stat. require Wisconsin banks to pay interest on escrow accounts?

A7: Not for loans originated after April 18, 2018. 2017 Wisconsin Act 340 eliminated the requirement that a financial institution pay interest on escrow accounts for residential mortgage loans originated on or after the effective date of Act 340. Thus, a Wisconsin financial institution is not required by law to pay interest on any escrow account maintained in association with a loan originated on or after April 18, 2018.

Wisconsin Statute section 138.052 previously required financial institutions to pay interest on the balance on any required escrow accounts. As discussed above, section 138.052 applies to consumer-purpose loans secured by a first lien or first lien equivalent in a 1-4 family dwelling that is used as the borrower's principal residence. Banks must continue to pay interest on escrow accounts they required prior to the effective date of Act 340. However, for any escrow account associated with a loan originated after the effective date of Act 340, section 138.052 no longer requires payment of interest. A bank should also consider the terms of its contract as to whether any payment of interest is part of the agreement.

Q8: Bank is closing loan in December for which bank will require escrow for the payment of taxes. The first mortgage payment will be in February. Can bank escrow for 2020 taxes to be paid in 2021?

A8. No. RESPA's escrow collection rules are prospective in nature. Bank should only collect for 2021 taxes to be paid either in December 2021 in a lump sum (with borrower's permission as outlined above) or in installments. Bank should not collect for anything between December 1 and 31st because nothing is owing during that time as the bank should only be collecting for 2021 taxes. Bank should not be collecting for 2020 taxes for payment in 2021. Borrower should be on his/her own to pay 2020 taxes. ■

CFPB Issues Revised General QM and New Seasonal QM Rules

Early this month, the Bureau of Consumer Financial Protection (CFPB) released two final rules regarding the rules affecting qualified mortgages (QM) under Regulation Z. This article is a highlight of the key provisions of the two new rules.

Background and Rationale for Revised General QM Rule

Under Regulation Z, the Ability-to-Repay/Qualified Mortgage Rule (ATR/QM Rule) requires a creditor to make a reasonable, good faith determination of a consumer's ability to repay a residential mortgage loan according to its terms. Loans that meet the ATR/QM Rule's requirements for QMs obtain certain protections from liability. The ATR/QM Rule defines several categories of QMs, including the General QM category.

General QMs must comply with the ATR/QM Rule's prohibitions on certain loan features, its points-and-fees limits, and its underwriting requirements. For General QMs, the consumer's debt-to-income (DTI) ratio must not exceed 43 percent. The ATR/QM Rule requires that creditors must calculate, consider, and verify debt and income for purposes of determining the consumer's DTI ratio using the standards contained in appendix Q of Regulation Z.