Wisconsin Bankers Association

Compliance Journal

December 2022

Special Focus

Wisconsin Updates its Limited Partnership and Limited Liability Company Laws

Under 2021 Wisconsin Act 258, Wisconsin's Uniform Limited Partnership Act (Ch. 179) and the Uniform Limited Liability Company Act (Ch. 183) have been updated to reflect recent revisions to the uniform laws Wisconsin's existing laws were based upon.

The revisions affect the business operations of a limited partnership and limited liability company (LLC) and duties owed amongst partners to a limited partnership and amongst members and managers to an LLC. Revisions also affect the content of filings with the Wisconsin Department of Financial Institutions (WDFI), entity dissolutions, and other business activities.

The changes do not have a direct impact on existing, common bank procedures used to establish a deposit or lending relationship or to complete bank customer due diligence (CDD) and customer identification program (CIP) procedures. Existing bank policies and procedures can continue as is further discussed below.

Act 258 has a phased-in effective date. The changes made by Act 258 apply to a limited partnership or LLC formed on or after **January 1, 2023**. The changes also apply on **January 1, 2023**, to a limited partnership or LLC formed before this date unless the limited partnership or LLC elect to be governed by the existing law applicable before enactment of Act 258. Limited partnerships or LLCs formed before **January 1, 2023**, also have the option to elect to be governed by Act 258 prior to **January 1, 2023**.

Each limited partnership and LLC in existence at the time of enactment of Act 258 need determine whether to follow existing law or be wrapped into the revised law. To be subject to the revisions made by Act 258, the limited partnership or LLC need do nothing; the new law will automatically apply to the limited partnership and LLC on January 1. Some limited partnerships and LLCs with a more complex and robust partnership agreement or operating agreement may desire to be governed by the old law. If this is the case, the limited partnership or LLC need file a Statement of Nonapplicability with WDFI by **December 31, 2022**, to remain subject to existing law. If an existing limited partnership or LLC sought to be subject to the new law prior to the January effective date, the entity would have filed a Statement of Applicability with WDFI.

The following is a summary of law changes regarding limited partnerships and LLCs as a result of Act 258.

Limited Partnership

Background

Wisconsin first adopted its Uniform Limited Partnership Act in 1919. The law was revised in 1983 to adopt the Revised Uniform Limited Partnership Act, with modifications, and then again in 1985. Act 258 repeals and recreates Wisconsin's limited partnership law to adopt the Revised Uniform Limited Partnership Act (2021), as last amended in 2013, with modifications.

Many provisions of the new law and Wisconsin's existing limited partnership law are similar, including the following:

- A limited partnership is a legal entity separate from its partners, and the filing of a certificate of limited partnership is required to form a limited partnership;
- A limited partnership is distinguished from a general partnership by the presence of limited partners;
- A limited partnership must have at least one general partner and at least one limited partner;
- The limited partnership generally is managed by general partners, and limited partners primarily provide capital for the limited partnership; and
- A partnership agreement usually provides rules of governance for the limited partnership, and, in many instances, statutory provisions are default rules that govern the limited partnership only in the absence of applicable terms in the partnership agreement. However, in some instances, the terms of the partnership agreement may not vary from statutory requirements.

The following are some of the more significant changes to Ch. 179 made by the enactment of Act 258.

Formation and Partnership Agreement

Currently, the limited partnership law in Wisconsin defines "limited partnership" as a partnership formed by two or more persons and having one or more general partners and one or more limited partners. To form a limited partnership, a certificate of limited partnership, containing certain information, is required to be filed with WDFI. The limited partnership is formed upon the filing of the certificate of limited partnership or, if a later date was specified in the certificate, on the later date.

Under Act 258, the formation of a limited partnership still requires a certificate of limited partnership containing specific information to be filed with WDFI. However, the limited partnership is not formed until the certificate of limited partnership is filed, and becomes effective, *and* the limited partnership has at least one general partner and at least one limited partner. A limited partnership now has perpetual duration unless the duration is otherwise modified in the partnership agreement. Under current law, the duration of the limited partnership (when the limited partnership must be dissolved) is required information within the certificate of limited partnership.

Act 258 permits a person to be both a general partner and a limited partner and that the rights, powers, duties, and obligations of such person are determined in the capacity in which the person acts. The name of a limited partnership may contain the name of any partner. The name of a limited partnership that is not a limited liability limited partnership must contain the words "limited partnership," or a variation of these words that differs only with respect to the capitalization of letters, or the abbreviation of "LP" or a variation of this abbreviation that differs only with respect to the capitalization of letters or punctuation.

Currently, a "partnership agreement" is defined to mean any valid agreement of the partners (limited and general partners) as to the affairs of the limited partnership and the conduct of its business. Provisions of the existing law relating to rights and duties of, and restrictions on a partner in a limited partnership apply only if there were no contrary provisions in the partnership agreement. Act 258 revises chapter 179 to provide more specific guidance than the existing law regarding when the provisions of a partnership agreement override contrary statutory provisions, and when they do not.

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Under Act 258, “partnership agreement” means the agreement, whether oral, implied, written or recorded in a tangible or electronic medium, of all the general and limited partners of a limited partnership concerning:

- Relations among the partners and between the partners and the limited partnership;
- The activities and affairs of the limited partnership and the conduct of those activities and affairs;
- The means and conditions for amending the partnership agreement; and
- Mergers and other reorganizations involving the limited partnership.

As to these matters, statutory provisions govern only in the absence of applicable provisions in the partnership agreement.

Act 258 also imposes restrictions on the terms of a partnership agreement, including that a partnership agreement may not vary from statutory provisions relating to the power of a person to dissociate as a general partner, the grounds for expulsion of a general partner because of certain conduct, causes of dissolution, requirements for winding up a limited partnership, requirements for filings with WDFI, law suits by and against partners and the limited partnership, records and information required to be kept by the limited partnership, a partner’s right to access records and information, a partner’s fiduciary and other duties, and the applicable law governing a limited partnership’s internal affairs and the liability of its partners.

Partnership Liability and LLLPs

Currently, a general partner of a limited partnership has the same liabilities as a partner in a partnership without limited partners (general partnership). In general, all partners in a general partnership are jointly and severally liable for all debts, obligations, and other liabilities of the general partnership. In contrast, a limited partner is generally not liable for the obligations of the limited partnership. However, there are exemptions if the limited partner is also a general partner or if the limited partner participates in the control of the business and a person who transacts business with the limited partnership reasonably believes that the limited partner is a general partner.

Under Act 258, general partners are, with exceptions, liable jointly and severally for all debts, obligations, and other liabilities of the limited partnership. Act 258 also eliminates the “control” exception under the previous law to a limited partner’s exemption from liability. Under Act 258, a limited partner is not personally liable for a debt, obligation, or other liability of the limited partnership solely by reason of being or acting as a limited partner, even if the limited partner participates in the management and control of the limited partnership.

Currently, a general partnership may form as or become a limited liability partnership (LLP), and a partner in an LLP is not personally liable for any debt, obligation, or liability of the LLP, except that under some circumstances the partner may be liable for the partner’s own actions or the actions of a person under the partner’s supervision and control.

Act 258 allows a limited partnership to form as or become a limited liability limited partnership (LLLP) by including a statement to this effect in the certificate of limited partnership. If a limited partnership is an LLLP, a general partner is not personally liable for a debt, obligation, or other liability of the LLLP solely by reason of being or acting as a general partner. Instead, a debt, obligation, or other liability incurred by the LLLP is solely that of the LLLP.

The name of an LLLP must contain the phrase “limited liability limited partnership,” or a variation of these words that differs only with respect to the capitalization of letters, or the abbreviation of “LLLP” or a variation of this abbreviation that differs only with respect to the capitalization of letters or punctuation, and may not contain the words “limited partnership” other than in the phrase “limited liability limited partnership” or the abbreviation “LP” other than in the abbreviation “LLLP.”

Operating Requirements

Currently, a limited partnership was required to maintain in Wisconsin a records office where specified limited partnership records are kept. Act 258 retains that requirement, and the requirement that the limited partnership maintain a registered agent for service of process in Wisconsin.

Act 258 requires limited partnerships to file with WDFI annual reports containing specified information. The Act also specifies records and information that the limited partnership must furnish to general partners and limited partners without demand, as well as information that the limited partnership must furnish to partners on demand. The duty to furnish information also applies to each general partner on whom a demand is made, not just to the limited partnership.

Act 258 also modifies other aspects of the limited partnership law including the basis under which a partner's dissociation from the limited partnership occurs, the conditions for which a limited partnership may merge, convert, or enter into other business-combination transactions, and actions by partners against the limited partnership. Act 258 also changes the grounds under which a limited partnership is dissolved and its activities and affairs wound up; there is no longer a presumptive dissolution of a limited partnership upon dissociation of a general partner.

Currently, except as provided in the partnership agreement, a general partner of a limited partnership generally has the rights and powers, and is subject to the restrictions, of a partner in a general partnership. In general, a partner in a general partnership owes to the partnership and to the other partners duties of loyalty and care and must discharge the partner's duties and obligations consistently with the contractual obligation of good faith and fair dealing.

Under Act 258, a general partner's duties to the limited partnership and to other partners is more directly specified. Act 258 also specifies the extent to which the statutory duties may be overridden by the partnership agreement and specifies a limited partner's duties.

Act 258 also allows a limited partnership to file with WDFI a statement of partnership authority. The statement may recognize or limit, for purposes of a third party dealing with the limited partnership, the authority of a person to act for or enter into transactions on behalf of the limited partnership. In the statement, the limited partnership may identify the authority, or limitations on the authority, of any person or position (which covers all persons holding that position). The statement of authority is effective for five years from its original date or its most recent amendment or renewal, and the statement affects only the power of a person to bind the limited partnership to persons that are not partners. Act 258 also allows any person named in a statement of authority to file with WDFI a statement of denial of authority.

Limited Liability Companies

Background

While there have been modifications over the years, Wisconsin first authorized the creation of LLCs in 1994. Act 258 repeals and recreates Wisconsin's LLC law (Ch. 183) to adopt the Revised Uniform Limited Liability Company Act (2006), as last amended in 2013 (RULLCA), subject to certain modifications.

Many provisions of the new law are similar to Ch. 183, including that an LLC: (a) is a distinct legal entity separate from its members and may be organized for any lawful purpose; (b) may be managed by its members or by managers; and (c) operating agreement between the members may provide rules of governance for the LLC. In many instances, the statutory provisions under Ch. 183 are merely default rules that govern an LLC only in the absence of applicable terms in an operating agreement. In some instances, however, the terms of an operating agreement may not vary from statutory requirements.

The following covers some of the more significant changes to Ch. 183 made by the enactment of Act 258.

Formation and Operating Agreement

Currently, an organizer files articles of organization with WDFI to form an LLC. The articles must include specific information and may not contain any additional information. Act 258 modifies the information required in articles of organization filed with WDFI and allows additional information to be included. Similar to the law change for limited partnerships outlined above, under Act 258, an LLC has perpetual duration, unless modified by the operating agreement. Act 258 allows a person to become a member of an LLC in any way provided for in the operating agreement.

Currently, an "operating agreement" is defined to include only a written document and allows for the possibility that an LLC could be formed and operate without an operating agreement. The term is defined as an agreement in writing, if any, among all of the members as to the conduct of the business of an LLC and its relationships with its members.

Under Act 258, the operating agreement may be oral or written, express or implied, and an LLC cannot exist without an operating agreement. Act 258 defines "operating agreement" to mean an agreement, whether or not referred to as an operating agreement and whether oral, implied, written or recorded in a tangible or electronic medium, or in any combination of these, of all the members of an LLC, including a sole member, concerning:

- Relations among the members as members and between the members and the LLC;
- The rights and duties of managers;
- The activities and affairs of the LLC and the conduct of those activities and affairs;
- The means and conditions for amending the operating agreement; and
- Mergers, conversions, and other business combinations.

Act 258 provides more specific guidance regarding when the provisions of an operating agreement override contrary statutory provisions and when they do not. Act 258 also includes a list of matters for which the operating agreement may not vary from statutory provisions, including matters related to a member's fiduciary and other duties. The name of an LLC must contain the phrase "limited liability company" or "limited company" or the abbreviation "LLC" or "LC" or a variation of these abbreviations that differ only with respect to capitalization of letters or punctuation. "Limited" may be abbreviated as "Ltd.," and "company" may be abbreviated as "Co.".

Act 258 makes changes to the information that must be contained in an LLC's annual report and makes some changes with respect to the records that an LLC must keep at its office. Act 258 also requires an LLC to furnish certain information, without request, to members and managers of LLCs. The updated law also contains provisions relating to the rights to information after a person dissociates as a member.

Other Changes

Act 258 also modifies other aspects of the LLC law including the duties owed by a member or manager to an LLC, dissolution and winding up the affairs of an LLC, requirements applicable to a merger or conversion involving an LLC, the option for a derivative action brought by a member against an LLC to enforce a right of the LCC and the ability of the LLC to appoint a special litigation committee to investigate the claims, and changes several terms used in LLC business filings.

Further, Act 258 generally eliminates the concept of "apparent authority" in connection with LLCs. Currently, in a member-managed LLC, each member is an agent of the LLC and, subject to exceptions, the act of a member for apparently carrying on the business of the LLC binds the LLC. This principle does not apply in a manager-managed LLC, where the managers, not the members, are the agents of the LLC for purposes of carrying on its business. Under Act 258, a member is not an agent of an LLC solely by reason of being a member.

Similar to the filing by a limited partnership as outlined above, an LLC may file with WDFI a statement of authority identifying the authority of any position with the LLC (which covers all persons holding that position), identifying the authority of any specific person, or identifying limitations on the authority of any position or person. The statement of authority is effective for five years from its original date or its most recent amendment or renewal. The statement affects only the power of a person to bind the LLC to persons that are not members. Act 258 allows any person named in a statement of authority to file with WDFI a statement of denial of authority.

Impact on Current Banking Procedures

The changes made by Act 258 primarily impact the duties and responsibilities partners have to the limited partnership and other partners and members and managers to their LLC and fellow members. The changes help provide clarity when there is conflict between the terms of a partnership agreement or operating agreement and a statutory provision and help clarify what statutory provisions cannot be altered by agreement. The changes made by Act 258 to chapters 179 and 183 largely do not change common, existing procedures used by banks to establish a deposit or loan relationship.

Currently, some partnerships do not have a partnership agreement and some LLCs do not have an operating agreement. In these situations, bank CDD and CIP procedures typically utilized information filings with WDFI and other non-documentation methods for satisfying Bank Secrecy Act (BSA) requirements. Under the revised law, for a limited partnership or LLC who have opted for an oral partnership agreement or oral operating agreement, banks can utilize their same methods as used before Act 258 when working with entities without partnership agreements or operating agreements.

Despite having the option of an oral partnership agreement or operating agreement, both limited partnerships and LLCs still have filing requirements with WDFI to create either entity. Banks could also look to WDFI filings to see whether a limited partnership or LLC filed a statement of authority as further indication of who has what authorities. Given the potential uncertainty of oral agreements as between partners or members, it remains to be seen how many limited partnerships or LLCs may adopt the oral agreement approach. There is certainly more clarity for partners and members to have such agreements in writing.

When establishing a deposit account relationship with an entity, banks still need execute a business signature card and business depository declaration or resolution. Similarly, when establishing a lending relationship with an entity, banks still need execute borrowing resolutions and other loan documents. Both deposit and borrowing resolutions or declarations have language stating that the executed bank documents are adopted in accordance with all agreements in existence with partners or in compliance with an LLC's articles of organization and any operating agreement. The representations, acknowledgments, and authorizations expressed in executed bank depository and borrowing resolutions remain effective despite Act 258.

For banks that collect partnership agreements or operating agreements of their limited partnership and LLC customers, existing limited partnerships and LLCs may update their partnership agreements or operating agreements as a result of Act 258. In such settings, banks could anticipate the limited partnership or LLC sharing its updated documents with the bank.

Conclusion

Through the enactment of 2021 Wisconsin Act 258, Wisconsin has revised its limited partnership and LLC uniform laws. The revisions apply to a limited partnership or LLC formed on or after **January 1, 2023**. The changes also apply on **January 1, 2023**, to a limited partnership or LLC formed before this date unless the limited partnership or LLC filed a Statement of Nonapplicability with WDFI by **December 31, 2022**, to remain subject to previous law. Limited partnerships or LLCs formed before **January 1, 2023**, also have the option to elect to be governed by Act 258 prior to **January 1, 2023**. To elect such option, the entity need file a statement of applicability with WDFI before the January 1 effective date.

The revisions can affect duties owed amongst partners to a limited partnership and amongst members and managers to an LLC. Revisions also broaden the content of filings with WDFI, affect entity dissolutions, and other business activities. The changes do not have a direct impact on existing, common bank procedures used to establish a deposit or lending relationship or to complete bank CDD and CIP procedures.

2021 Wisconsin Act 258 may be viewed at: https://docs.legis.wisconsin.gov/2021/related/acts/258.pdf

Technical Amendment Lowers Closed-End Mortgage Loan HMDA Reporting Threshold

The Bureau of Consumer Financial Protection (CFPB) issued a technical amendment to lower the closed-end mortgage loan reporting threshold for Regulation C, which implements the Home Mortgage Disclosure Act (HMDA). The amendment was issued as a result of a recent court case which invalidated the higher reporting threshold for closed-end mortgage loans. WBA first reported on the court case in the October 2022 *WBA Compliance Journal*. The technical amendment followed a previously issued blog post by CFPB. The amendment is effective upon publication in the *Federal Register*, December 21, 2022. A link to the technical amendment may be found below.

Summary

In April 2020, CFPB issued a final rule (2020 HMDA Rule) to amend Regulation C to increase the threshold for reporting data about closed-end mortgage loans. The 2020 HMDA Rule increased the closed-end mortgage loan reporting threshold from 25 loans to 100 loans in each of the two preceding calendar years, effective July 1, 2020.

On September 23, 2022, the United States District Court for the District of Columbia vacated the 2020 HMDA Rule as to the increased loan-volume reporting threshold for closed-end mortgage loans. As a result of the September 23, 2022 order, the threshold for reporting data about closed-end mortgage loans is 25, the threshold established by the 2015 HMDA Rule. Accordingly, the technical amendment updates the Code of Federal Regulations to reflect the closed-end mortgage loan reporting threshold of 25 mortgage loans in each of the two preceding calendar years.

Background

HMDA requires certain banks, savings associations, credit unions, and for-profit non-depository institutions to collect, report, and disclose data about originations and purchases of mortgage loans, as well as mortgage loan applications that do not result in originations (for example, applications that are denied or withdrawn). CFPB's Regulation C, 12 CFR part 1003, implements HMDA, 12 U.S.C. 2801 through 2810.

In October 2015, CFPB issued a final rule (2015 HMDA Rule) that, among other things, established institutional and transactional loan-volume coverage thresholds in Regulation C that determine whether financial institutions are required to report certain HMDA data on closed-end mortgage loans or open-end lines of credit. The thresholds apply uniformly to covered depository and non-depository institutions; they took effect for depository institutions on January 1, 2017, and for non-depository institutions on January 1, 2018. The loan-volume thresholds in the 2015 HMDA Rule required an institution that originated at least 25 closed-end mortgage loans or at least 100 open-end lines of credit in each of the two preceding calendar years to report HMDA data, provided that the institution meets all other criteria for institutional coverage.

In April 2020, CFPB issued a final rule (2020 HMDA Rule) to amend Regulation C to increase the thresholds for reporting data about both closed-end mortgage loans and open-end lines of credit. In particular, the 2020 HMDA Rule set the closed-end mortgage loan reporting threshold at 100 in each of the two preceding calendar years, effective July 1, 2020, and the open-end line of credit reporting threshold at 200 in each of the two preceding calendar years, effective January 1, 2022.

On July 30, 2020, five nonprofit organizations and the City of Toledo, Ohio, initiated a lawsuit challenging the 2020 HMDA Rule. On September 23, 2022, the United States District Court for the District of Columbia concluded that the 2020 HMDA Rule's increased reporting threshold for closed-end mortgage loans was arbitrary and capricious. The court issued an order vacating and remanding the loan-volume reporting threshold for closed-end mortgage loans under the 2020 HMDA Rule. Accordingly, the threshold for reporting data about closed-end mortgage loans is 25 in each of the two preceding calendar years, which is the threshold set by the 2015 HMDA Rule.

The technical amendment reflects the vacatur in the Code of Federal Regulations by replacing the closed-end reporting threshold numbers in Regulation C sections 1003.2(g)(1)(v)(A) and (2)(ii)(A), and 1003.3(c)(11), and comments 2(g)–5 and 3(c)(11)–2 with those in effect on June 30, 2020; and replacing in their entirety, comments 2(g)–1 and 3(c)(11)–1 with the versions in effect on June 30, 2020.

Separate CFPB Statement

On December 6, 2022, a blog post appeared on CFPB's website regarding the change to HMDA's closed-end reporting threshold as a result of the court case. In that post, CFPB stated:

> "The CFPB recognizes that financial institutions affected by this change may need time to implement or adjust policies, procedures, systems, and operations to come into compliance with their reporting obligations. In these limited circumstances, in allocating the CFPB's enforcement and supervisory resources, the CFPB does not view action regarding these institutions' HMDA data as a priority. Thus, the CFPB does not intend to initiate enforcement actions or cite HMDA violations for failures to report closed-end mortgage loan data collected in 2022, 2021, or 2020 for institutions subject to the CFPB's enforcement or supervisory jurisdiction that meet Regulation C's other coverage requirements and originated at least 25 closed-end mortgage loans in each of the two preceding calendar years but fewer than 100 closed-end mortgage loans in either or both of the two preceding calendar years."

Unfortunately, the blog post did not offer further guidance to first assist small banks with how best to proceed given the new lower threshold. No other banking regulator has issued guidance as a result of the court case or CFPB's releases. WBA continues its efforts with the federal banking regulators to obtain more guidance regarding the lower reporting thresholds for small entities impacted by the outcome of this court case. Given the impact of the court case and technical amendment to Regulation C, banks which meet the 25 closed-end mortgage loan threshold for 2021 and 2022 should look to collect and report closed-end mortgage loan HMDA data for 2023. The exemption threshold for open-end lines of credit remains untouched at 200 open-end lines of credit originated in each of the prior two years.

The technical amendments may be viewed at:
https://www.govinfo.gov/content/pkg/FR-2022-12-21/pdf/2022-27204.pdf

The blog post may be viewed at:
https://www.consumerfinance.gov/about-us/blog/changes-to-hmda-closed-end-loan-reporting-threshold/

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Special Focus

FinCEN Issues Final Beneficial Ownership Information Reporting Requirements.

On September 30, 2022, the Financial Crimes Enforcement Network (FinCEN) published in the *Federal Register* a final rule which sets forth the requirements of certain entities to file with FinCEN reports which identify two categories of individuals: the beneficial owners of the entity, and individuals who have filed an application with specified governmental authorities to create the entity or register it to do business.

The rule implements Section 6403 of the Corporate Transparency Act (CTA), enacted into law as part of the National Defense Authorization Act (NDAA), and describes who must file a report, what information must be provided, and when a report is due. The requirements are intended to help prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity, while minimizing the burden on entities doing business in the United States.

The final rule is the first of a series of rules FinCEN need release to implement CTA; a second rule regarding access to the database of reported information and yet another rule to revise the existing customer due diligence rule are forthcoming. How these information reporting rules will directly impact financial institutions is still playing out. The final rule is effective **January 1, 2024**. The following is a summary of the new rule.

1. Reports of Beneficial Ownership Information

The primary purpose of the final rule is to require reporting companies to file reports with FinCEN which contain information required by the final rule. There are three types of reports: an initial, updated, and a corrected report.

<u>Initial Report</u>

The new rule requires each reporting company to file an initial report in the form and manner as specified in the rule. Any domestic reporting company created on or after 01/01/2024, must file a report within thirty (30) calendar days of the earlier of (a) the date on which the entity receives actual notice that its creation has become effective or (b) the date on which a Secretary of State Office or similar office first provides public notice, such as through a publicly accessible registry, that the domestic reporting company has been created. In Wisconsin, the applicable office would be the Department of Financial Institutions (WDFI).

For any entity that becomes a foreign reporting company on or after 01/01/2024, the initial report must be filed within 30 calendar days of the earlier of (a) the date on which it receives actual notice that it has been registered to do business or (b) the date on which a Secretary of State Office or similar office (*i.e.*, WDFI) first provides public notice, such as through a publicly accessible registry, that the foreign reporting company has been registered to do business.

Any domestic reporting company created before 01/01/2024, and any entity that became a foreign reporting company before 01/01/2024, must file a report not later than 01/01/2025. Any entity that no longer meets the criteria for any exemption under the rule must file an initial report within 30 calendar days after the date that it no longer meets the criteria for any exemption.

Content of Initial Report

The initial report must be filed with FinCEN in the form and manner that FinCEN has yet to prescribe, by following FinCEN instructions for the form. Each person filing such report must certify that the report is true, correct, and complete.

An initial report of a reporting company must include the following information:

For the reporting company:

- The full legal name of the reporting company;
- Any trade name or "doing business as" name of the reporting company;
- A complete current address consisting of:
    - In the case of a reporting company with a principal place of business in the United States, the street address of such principal place of business; and
    - In all other cases, the street address of the primary location in the United States where the reporting company conducts business;
- The State, Tribal, or foreign jurisdiction of formation of the reporting company;
- For a foreign reporting company, the State or Tribal jurisdiction where such company first registers; and
- The Internal Revenue Service (IRS) Taxpayer Identification Number (TIN) (including an Employer Identification Number (EIN)) of the reporting company, or where a foreign reporting company has not been issued a TIN, a tax identification number issued by a foreign jurisdiction and the name of such jurisdiction.

For every individual who is a beneficial owner of such reporting company, and every individual who is a company applicant with respect to such reporting company:

- The full legal name of the individual;
- The date of birth of the individual;
- A complete current address consisting of:
    - In the case of a company applicant who forms or registers an entity in the course of such company applicant's business, the street address of such business; or
    - In any other case, the individual's residential street address;
- A unique identifying number and the issuing jurisdiction from one of the following documents:
    - A non-expired passport issued to the individual by the United States government;
    - A non-expired identification document issued to the individual by a State, local government, or Indian tribe for the purpose of identifying the individual;
    - A non-expired driver's license issued to the individual by a State; or
    - A non-expired passport issued by a foreign government to the individual, if the individual does not possess any of the documents described directly above in this section; and
- An image of the document from which the unique identifying number was obtained.

There are special rules to also consider when filing the initial report for exempt entities who have an ownership interest in a reporting company, when a beneficial owner is a minor, and for a foreign pooled investment vehicle.

In particular, if one or more entities that are exempt under this rule has or will have a direct or indirect ownership interest in a reporting company and an individual is a beneficial owner of the reporting company exclusively by virtue of the individual's ownership interest in such exempt entities, the report may include the names of the exempt entities in lieu of the information required with respect to such beneficial owner.

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If a reporting company reports the information required in an initial report and the beneficial owner is a minor, then the report need indicate that such information relates to a parent or legal guardian. And, if an entity would be a reporting company but for the exemption in the final rule for a pooled investment vehicle and is formed under the laws of a foreign country, such entity shall be deemed a reporting company for purposes of filing an initial report, except the report shall include the information required with respect to an individual who exercises substantial control over the entity. If more than one individual exercises substantial control over the entity, the entity must report information with respect to the individual who has the greatest authority over the strategic management of the entity.

If a reporting company was created or registered before 01/01/2024, the reporting company must report that fact, but is not required to report information with respect to any company applicant.

Updated Report

If there is any change with respect to required information previously submitted to FinCEN concerning a reporting company or its beneficial owners, including any change with respect to who is a beneficial owner or information reported for any particular beneficial owner, the reporting company must file an updated report in the form and manner specified in the final rule within 30 calendar days after the date on which such change occurs.

The final rule provides specific activities which are considered the type of change which requires the filing of an updated report. Those activities include:

- If a reporting company meets the criteria for any exemption under the final rule subsequent to the filing of an initial report, this change is deemed a change which would require the entity to file an updated report.

- If an individual is a beneficial owner of a reporting company by virtue of property interests or other rights subject to transfer upon death, and such individual dies, once the estate of the deceased beneficial owner is settled, either through the operation of the intestacy laws of a jurisdiction within the United States or through a testamentary deposition, this event is deemed a change which would require an updated report to be filed. The updated report must, to the extent appropriate, identify any new beneficial owners.

- If a reporting company has reported information with respect to a parent or legal guardian of a minor child as required under the final rule, when the minor child attains the age of majority, this event is deemed a change which would require an updated report to be filed.

- With respect to an image of an identifying document required to be reported in the initial report, when the name, date of birth, address, or unique identifying number on such document changes, this change is deemed one that would require the entity to file an updated report.

In general, when an updated report is required to be filed, it must reflect any change with respect to the required information previously submitted to FinCEN concerning a reporting company or its beneficial owners.

FinCEN will prescribe the form and instructions for the updated report, and each person filing the updated report will be required to certify that the updated report is true, correct, and complete. If the requirement to file an updated report is due to the reporting company being a newly exempt entity, the updated report must indicate that the filing entity is no longer a reporting company.

Corrected Report

If any filed report was inaccurate when filed and remains inaccurate, the final rule requires the reporting company to file a corrected report 30 calendar days after the date on which such reporting company becomes aware or has reason to know of the inaccuracy. A corrected report filed within the 30-day period is deemed to satisfy the requirements under CTA at 31 U.S.C. 5336(h)(3)(C)(i)(I)(bb) if filed within 90 calendar days after the date on which the inaccurate report was filed.

Similar to the other reports, FinCEN will prescribe a form and instructions for the corrected report, and each person filing the updated report will be required to certify that the updated report is true, correct, and complete. The corrected report must correct all inaccuracies in the information previously reported to FinCEN.

2. FinCEN Identifier

A FinCEN Identifier is a unique identifying number that FinCEN will issue to individuals or reporting companies upon request, subject to certain conditions. For individuals, FinCEN will issue a FinCEN Identifier if an individual submits to FinCEN the same four pieces of identifying information as would be required in an Initial Report. A reporting company may obtain a FinCEN Identifier by submitting to FinCEN an application at or after the time that the entity submits an initial report. Each FinCEN Identifier shall be specific to each such individual or reporting company, and each such individual or reporting company (including any successor reporting company) may obtain only one FinCEN Identifier.

If an individual has obtained a FinCEN Identifier and has provided such FinCEN Identifier to a reporting company, the reporting company may include the FinCEN Identifier in its report in lieu of the information otherwise required in the initial report with respect to such individual.

Any individual that has obtained a FinCEN Identifier is required to update or correct any information previously submitted to FinCEN in an application for the FinCEN Identifier. The updated application need be filed within 30 calendar days after the date on which such change occurs. A corrected application need be filed within 30 calendar days after the date on which the individual becomes aware or has reason to know of the inaccuracy. Same requirements and timings apply to a reporting company that has obtained a FinCEN Identifier and previously filed information need be updated or corrected.

3. Select Definitions

The rule defines the term "**Reporting Company**" as either a domestic reporting company or a foreign reporting company. A domestic reporting company means any entity that is: a corporation; a limited liability company; or created by the filing of a document with a Secretary of State or any similar office under the law of a State or Indian tribe. A foreign reporting company is any entity that is: (1) a corporation, limited liability company, or other entity; (2) formed under the law of a foreign country; and (3) registered to do business in any State or Tribal jurisdiction by the filing of a document with a Secretary of State or any similar office under the law of a State or Indian tribe.

The rule provides over twenty **exemptions** from the definition of "reporting company" including: (1) a governmental authority; (2) banks; (3) credit unions; (4) bank holding company; (5) an MSB registered with FinCEN; (6) broker or dealer in securities; (7) investment company or investment advisor, (8) insurance company; (9) accounting firm, (10) tax-exempt entity; (11) public utility; and (12) a large operating company.

The rule defines "large operating company" as an entity that: (1) employs more than 20 full-time employees in the United States; (2) has an operating presence at a physical office within the United States; and (3) filed a Federal income tax or information return in the United States for the previous year demonstrating more than $5,000,000 in gross receipts or sales, as reported as gross receipts or sales (net of returns and allowances) on the entity's IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120–S, IRS Form 1065, or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under Federal income tax principles.

The term ''**beneficial owner**,'' with respect to a reporting company, means any individual who, directly or indirectly, either exercises substantial control over such reporting company or owns or controls at least 25 percent of the ownership interests of such reporting company.

The term ''beneficial owner'' **does not** include:

- A minor child, as defined under the law of the State or Indian tribe in which a domestic reporting company is created or a foreign reporting company is first registered, provided the reporting company reports the required information of a parent or legal guardian of the minor child as required by the rule;
- An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual;
- An employee of a reporting company, acting solely as an employee, whose substantial control over or economic benefits from such entity are derived solely from the employment status of the employee, provided that such person is not a senior officer as defined in the rule;

- An individual whose only interest in a reporting company is a future interest through a right of inheritance;
- A creditor of a reporting company as defined in the rule.

An individual "**exercises substantial control**" over a reporting company if the individual:
- Serves as a senior officer of the reporting company;
- Has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body);
- Directs, determines, or has substantial influence over important decisions made by the reporting company, including decisions regarding:
    - The nature, scope, and attributes of the business of the reporting company, including the sale, lease, mortgage, or other transfer of any principal assets of the reporting company;
    - The reorganization, dissolution, or merger of the reporting company;
    - Major expenditures or investments, issuances of any equity, incurrence of any significant debt, or approval of the operating budget of the reporting company;
    - The selection or termination of business lines or ventures, or geographic focus, of the reporting company;
    - Compensation schemes and incentive programs for senior officers;
    - The entry into or termination, or the fulfillment or non-fulfillment, of significant contracts;
    - Amendments of any substantial governance documents of the reporting company, including the articles of incorporation or similar formation documents, bylaws, and significant policies or procedures; or
- Has any other form of substantial control over the reporting company.

An individual may **directly or indirectly**, including as a trustee of a trust or similar arrangement, **exercise substantial control** over a reporting company through:
- Board representation;
- Ownership or control of a majority of the voting power or voting rights of the reporting company;
- Rights associated with any financing arrangement or interest in a company;
- Control over one or more intermediary entities that separately or collectively exercise substantial control over a reporting company;
- Arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees; or
- Any other contract, arrangement, understanding, relationship, or otherwise.

The term ''**ownership interest**'' means:
- Any equity, stock, or similar instrument; preorganization certificate or subscription; or transferable share of, or voting trust certificate or certificate of deposit for, an equity security, interest in a joint venture, or certificate of interest in a business trust; in each such case, without regard to whether any such instrument is transferable, is classified as stock or anything similar, or confers voting power or voting rights;
- Any capital or profit interest in an entity;
- Any instrument convertible, with or without consideration, into any share or instrument described in the rule; or
- Any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership.

An individual may directly or indirectly **own or control an ownership interest** of a reporting company through any contract, arrangement, understanding, relationship, or otherwise, including:
- Joint ownership with one or more other persons of an undivided interest in such ownership interest;
- Through another individual acting as a nominee, intermediary, custodian, or agent on behalf of such individual;
- With regard to a trust or similar arrangement that holds such ownership interest:
    - As a trustee of the trust or other individual (if any) with the authority to dispose of trust assets;
    - As a beneficiary who:
        - Is the sole permissible recipient of income and principal from the trust; or
        - Has the right to demand a distribution of or withdraw substantially all of the assets from the trust; or
        - As a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust; or
        - Through ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of any such entities, that separately or collectively own or control ownership interests of the reporting company.

In determining whether an individual **owns or controls at least 25 percent of the ownership interests** of a reporting company, the total ownership interests that an individual owns or controls, directly or indirectly, must be calculated as a percentage of the total outstanding ownership interests of the reporting company as follows:

- Ownership interests of the individual shall be calculated at the present time, and any options or similar interests of the individual shall be treated as exercised;
- For reporting companies that issue capital or profit interests (including entities treated as partnerships for federal income tax purposes), the individual's ownership interests are the individual's capital and profit interests in the entity, calculated as a percentage of the total outstanding capital and profit interests of the entity;
- For corporations, entities treated as corporations for federal income tax purposes, and other reporting companies that issue shares of stock, the applicable percentage shall be the greater of:
    - the total combined voting power of all classes of ownership interests of the individual as a percentage of total outstanding voting power of all classes of ownership interests entitled to vote, or
    - the total combined value of the ownership interests of the individual as a percentage of the total outstanding value of all classes of ownership interests; and
- If the facts and circumstances do not permit the calculations described above with reasonable certainty, any individual who owns or controls 25 percent or more of any class or type of ownership interest of a reporting company shall be deemed to own or control 25 percent or more of the ownership interests of the reporting company.

The term ''**company applicant**'' for a domestic reporting company is the individual who directly files the document that creates the domestic reporting company. For a foreign reporting company, the company applicant is the individual who directly files the document that first registers the foreign reporting company. Whether for a domestic or a foreign reporting company, a company applicant is the individual who is primarily responsible for directing or controlling such filing if more than one individual is involved in the filing of the document.

Summary

FinCEN has issued a final rule, effective **01/01/2024**, which sets forth the requirements of certain entities to file with FinCEN reports that identify the beneficial owners of the entity and individuals who have filed an application with specified governmental authorities to create the entity or register it to do business.

The reporting requirements are intended to help prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity, while minimizing the burden on entities doing business in the United States.

The final rule is the first of a series of rules FinCEN need release to implement CTA; a second rule regarding access to the database of reported information and yet another rule to revise the existing customer due diligence rule are forthcoming. How these information reporting rules will directly impact financial institutions is still playing out.

The final rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-09-30/pdf/2022-21020.pdf

Recent CFPB Releases Address Certain Deposit Account Fees and Consumer Report Activities.

The Bureau of Consumer Financial Protection (CFPB) has released several forms of guidance over the past several weeks. The items focus on overdraft charges, return deposit fees, the duties of consumer reporting agencies to establish policy and procedures to ensure information within consumer reports is accurate, and reasonable investigation of consumer reporting duties.

While the information is "guidance" and not law, it is important that financial institutions be aware of the guidance in the event other prudential regulators attempt to adopt the same position as CFPB regarding the activities addressed in the releases. The following is a recap of the recently released CFPB guidance.

Unanticipated Overdraft Fee Assessment Practices

On October 26, 2022, CFPB issued Consumer Financial Protection Circular, 2022-06: Unanticipated Overdraft Fee

Assessment Practices, in which CFPB presented the question: Can the assessment of overdraft fees constitute an unfair act or practice under the Consumer Financial Protection Act (CFPA), even if the entity complies with the Truth in Lending Act (TILA) and Regulation Z, and the Electronic Fund Transfer Act (EFTA) and Regulation E?

As a reminder, an overdraft fee is a charge distinct from a non-sufficient fee (NSF). An overdraft occurs when the customer has insufficient funds in an account to cover a transaction, but the financial institution still pays the item. Alternatively, an NSF is assessed when the account balance is not sufficient to pay the item and the item is returned unpaid.

CFPB responded affirmatively to the above question stating, yes—overdraft fee practices need comply with applicable regulations and the prohibition against unfair, deceptive, and abusive acts or practices in Section 1036 of the CFPA. In particular, CFPB stated that overdraft fees assessed by financial institutions on transactions that a consumer would not reasonably anticipate are likely unfair and believes the charges likely impose substantial injury on consumers that they cannot reasonably avoid and that is not outweighed by countervailing benefits to consumers or competition.

CFPB further stated that unanticipated overdraft fees may arise in a variety of circumstances and focused the discussion within the circular on transactions CFPB referred to as "authorized positive, settle negative" (APSN).

CFPB explained that unanticipated overdraft fees can occur on APSN transactions, when a financial institution assesses an overdraft fee for a debit card transaction where the consumer had sufficient available balance in their account to cover the transaction at the time the consumer initiated the transaction and the financial institution authorized it, but due to intervening authorizations, settlement of other transactions (including the ordering in which transactions are settled), or other complex processes, the financial institution determined that the consumer's balance was insufficient at the time of settlement. These overdraft fees are assessed on consumers who are opted in to overdraft coverage for one-time debit card and ATM transactions, but they likely did not expect overdraft fees for these transactions and therefore are considered "unanticipated" by CFPB.

CFPB provides two examples as illustrations. The first is meant to be an example of overdraft fees involving a debt card transaction with an intervening debit transaction. The consumer is charged an overdraft fee even though the consumer's available balance was positive at the time the consumer entered into the debit card transaction.

The second example is meant to illustrate how financial institutions may process overdraft fees on two transactions. In this example the consumer is charged an additional overdraft fee when the financial institution assesses fees based upon available balance versus if the financial institution had used the account's ledger balance for fee assessment.

Unfair Returned Deposited Item Fee

Also on October 26th, CFPB issued Compliance Bulletin, 2022-06: Unfair Returned Deposited Item Fee Assessment Practice. CFPB issued the bulletin to notify regulated entities how it intends to exercise its enforcement and supervisory authorities on the issue.

A returned deposited item is a check that a customer deposits into their account that is returned to the customer because the check could not be processed against the check originator's account. It is CFPB's position that blanket policies of charging returned deposited item fees to consumers for all returned transactions irrespective of the circumstances or patterns of behavior on the account are likely unfair under the CFPA.

CFPB has identified that there are many reasons deposited items can be returned unprocessed. For example, the check originator may not have sufficient funds available in their account to pay the amount stated on the check; the check originator may have directed the issuing depository institution to stop payment; the account referenced on the check may be closed or located in a foreign country; or there may be questionable, erroneous, or missing information on the check, including with respect to the signature, date, account number, or payee name. However, because the consumer cannot reasonably avoid the charge, avoid the "injury," despite the charge being fully disclosed under the requirements of the Truth in Savings Act and Regulation DD, CPFB considers the charge to likely be unfair under CFPA.

CFPB attempts to distinguish between circumstances between blanketed returned deposited item polices which CFPB believes are not targeted to address patterns of behavior indicative of fraud or other circumstances where the consumer reasonably should have anticipated that the check would be returned.

So, under CFPB's theory if the financial institution believes the consumer reasonably should have anticipated that the check would have been returned, charging a returned deposited item fee in that instance is likely not unfair under the CFPA.

Fair Credit Reporting; Facially False Data

CFPB issued an Advisory Opinion to highlight that a consumer reporting agency (CRA) that does not implement reasonable internal controls to prevent the inclusion of facially false data, including logically inconsistent information, in consumer reports it prepares is not using reasonable procedures to assure maximum possible accuracy under section 607(b) of the Fair Credit Reporting Act (FCRA).

Consumer report accuracy depends on the various parties to the consumer reporting system, including: the three nationwide CRAs (Equifax, Experian, and TransUnion); other CRAs, such as background screening companies; entities such as creditors who furnish information to CRAs (*i.e.*, furnishers); and public record repositories. CFPB believes a CRA is uniquely positioned to identify certain obvious inaccuracies and implement policies, procedures, and systems to keep inaccuracies off of consumer reports. In some cases, such as when certain account or other information fields on consumer reports are logically inconsistent with other fields of information, a CRA can detect the logical inconsistencies and prevent the inaccurate information from being included in consumer reports it generates, thereby avoiding the consumer harm to individual consumers that can result from reporting such inaccurate information.

CFPB also shared in the advisory opinion that it continues to see accuracy issues at furnishers and CRAs through supervisory activities. For example, CFPB noted in its Spring 2022 *Supervisory Highlights* that many furnishers lacked "reasonable written policies and procedures regarding the accuracy and integrity of the information relating to consumers." In its Summer 2021 *Supervisory Highlights*, CFPB explained that some CRAs lacked adequate procedures for assuring maximum possible accuracy of consumer reports when they "continued to include information in consumer reports that was provided by unreliable furnishers."

CFPB stated it also continues to find accuracy issues in the consumer reporting context through its enforcement activities. For example, CFPB has brought enforcement actions against CRAs whose inadequate "name-only matching" led to reports with inaccurate derogatory criminal and public records information on consumers. CFPB has also brought enforcement actions against furnishers who furnish information with inherent logical inconsistencies, such as furnishing an increasing "original loan amount" over time, where that field should not change.

Reasonable Investigation of Consumer Reporting Duties

On November 10, 2022, CFPB released Consumer Financial Protection Circular, 2022-07: Reasonable Investigation of Consumer Reporting Duties. In the release CFPB answered two questions: (1) are CRAs and the entities that furnish information to them (furnishers) permitted under FCRA to impose obstacles that deter submission of disputes; and (2) do CRAs need to forward to furnishers consumer-provided documents attached to a dispute?

CFPB answered the questions by responding that no, CRAs and furnishers can be liable under FCRA if they fail to investigate any dispute that meets the statutory and regulatory requirements, as described in more detail in the circular. Enforcers may bring claims if CRAs and furnishers limit consumers' dispute rights by requiring any specific format or requiring any specific attachment such as a copy of a police report or consumer report beyond what the statute and regulations permit.

As to the second question, CFPB's response is that it depends. CFPB stated that enforcers may bring a claim if a CRA fails to promptly provide to the furnisher "all relevant information" regarding the dispute that the CRA receives from the consumer. While there is not an affirmative requirement to specifically provide original copies of documentation submitted by consumers, it would be difficult for a CRA to prove they provided all relevant information if they fail to forward even an electronic image of documents that constitute a primary source of evidence.

Summary

CFPB has recently released guidance documents regarding deposit account fees, information within consumer reports, and investigation into disputes of information within consumer reports. While the information is "guidance" and not law, it is important that financial institutions be aware of the guidance.

In recent panel discussions with other federal prudential regulators (Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, and Office of the Comptroller of the Currency), the agencies did not affirmatively state they have adopted the positions as outlined in the CFPB documents. However, financial institutions are reminded that the regulators have previously warned against charging overdraft fees in an APSN setting.

The federal prudential regulators have previously identified APSN as an area of concern and financial institutions are cautioned to track such transactions to avoid charging an overdraft fee on transactions which were authorized when an account balance was positive despite a negative balance upon settlement. Prior regulator instruction regarding APSN transactions can be viewed at the following two links: www.federalreserve.gov/publications/2018-july-consumer-compliance-supervision-bulletin.htm and www.fdic.gov/regulations/examinations/consumer-compliance-supervisory-highlights/documents/ccs-highlights-june2019.pdf

CFPB's guidance documents may be viewed at:

Unanticipated Overdraft Fee Assessment Practices
https://www.govinfo.gov/content/pkg/FR-2022-11-07/pdf/2022-23982.pdf

Unfair Returned Deposited Item Fee
https://www.govinfo.gov/content/pkg/FR-2022-11-07/pdf/2022-23933.pdf

Fair Credit Reporting; Facially False Data
https://www.govinfo.gov/content/pkg/FR-2022-10-26/pdf/2022-23264.pdf

Reasonable Investigation of Consumer Reporting Duties
https://www.consumerfinance.gov/compliance/circulars/consumer-financial-protection-circular-2022-07-reasonable-investigation-of-consumer-reporting-disputes/

Wisconsin Bankers Association

Compliance Journal

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Special Focus

Part Two: Considerations when Banking Minors

There are several banking relationships which may involve minors. Be it an adult who wants their child to learn about finances through a deposit account or even a loan, a fourteen-year-old who just got their first job and needs a means to deposit payroll checks, a custodial account setup by grandpa and grandma for college savings, or a minor acting as joint lessee on a safe deposit box, there is much to consider when banking minors.

In this article, WBA Legal continues the conversation about what banks should consider when banking minors. Part One of the series answered the most frequently asked questions WBA Legal receives regarding WUTMA accounts; the questions were exclusively focused on deposit account relationships. This article is meant to address the topic of contracting with minors more globally, including the doctrine of incapacity.

Minor Can Execute a Contract

The first question that WBA Legal often receives regarding minors is: Can minors open an account? Or to phrase it more broadly: Can minors enter into a contract? The answer to both is: yes, banks can do business with minors, including opening deposit accounts and extending credit. Minors can enter into contracts. However, a bank also need consider that a minor can escape liability under the contract based upon defenses under contract law.

Contract Defense for a Minor

Banks entering into a contract with minors need know that a minor could void liability from a bank seeking to hold the minor accountable for terms under the contract. This means that while a bank can contract with minors, doing so can present unique risks and liabilities.

The ability of a minor to escape, or void, liability under a contract is often referred to as the doctrine of incapacity. Generally speaking, the theory is that a minor has not mentally developed enough to understand the significance of contracting and thus, to protect the minor, may void the contract. As a general rule under contract law, until a person obtains the age of 18, the doctrine of incapacity will be a notable defense under disputes related to contract terms. It is also worth mentioning that a court could find that someone who has attained the age of 18, or older, still hasn't matured enough to understand that significance and might be permitted to void the contract.

Before frontline staff enter into a deposit, loan, or other contractual relationship with a minor, staff should be sure to first review bank policies and procedures regarding contracting with minors.

Considerations

Knowing that banks may contract with minors, when banks look to establish policies and procedures involving minors, each bank need consider the risks associated with establishing such contractual relationships and determine how much risk the bank is willing to accept. The risks will vary depending upon product and services. For example, establishing a savings deposit account with a minor is potentially less risky than extending credit or offering very sophisticated products and services to the minor. This is a matter for every bank to decide, as a matter of business.

In weighing such risks, together with the types of products the bank offers, and the desire for such products from minors, bank should evaluate what it is comfortably willing and able to accommodate. While there are numerous possibilities, and this is ultimately a business decision, the following sections outline risk considerations for several types of contracts involving minors.

Joint Contracts

Some banks may make the business decision to not enter into a contract with a minor individually, but may consider establishing a joint contract, such as a jointly-held deposit account between a minor and an adult. Some banks may be willing to consider this type of contract if the language of the contract includes joint and several liability language as such language would allow for the bank to be made whole from the adult party even if the minor can void liability under the contract.

When considering a joint contract between a minor and an adult, a bank should only consider the joint account option if the minor is old enough to sign the contract. For example, without having all joint accountholders sign the deposit account contract, the concern for the bank is whether a joint deposit account contract was actually established. Additionally, under the Federal Deposit Insurance Corporation's (FDIC's) deposit insurance coverage rules, all parties of a joint deposit account need personally sign the signature card for the deposit account be considered a joint account under FDIC's rules. See 12 CFR Part 330.9.

Minor by Adult Contract

Some banks may make the business decision to create a contract structure commonly referred to as a "minor by adult" arrangement; for example, Mary Minor by Andrew Adult. Under this structure, the intention of the parties is typically that the adult would act on the behalf of the minor.

While not invalid, when considering such structure, banks should consider what rules or requirements would apply as it is not clear from the structure itself how the adult is to act regarding the minor or what rights the minor would have under the agreement. For example, if a deposit account is established as a "minor by adult" arrangement, questions to consider include when may the minor to have access to the funds; what happens if the adult becomes incapacitated, dies or otherwise is no longer able or willing to act for the minor; and what happens if the minor dies before receiving the funds from the account.

As an alternative to the minor by adult account arrangement, banks may want to consider an account established for the minor under the terms of Wisconsin's Uniform Transfers to Minors Act (WUTMA) as the Act provides more certainties around the handling of the deposit account and the rights and responsibilities of both the minor and custodian. See Part One of this article series for more information regarding WUTMA accounts.

Individual Contract

Another option is for the bank to execute an individual contract with the minor. As mentioned above, a minor may enter into a contract with the bank. However, a risk to the bank is that the minor may void the contract or may escape liability. For those banks contracting individually with minors, the banks are typically contracting with minors who are of working age and generally are more understanding of acting responsibly than a young minor not able to sign or more fully able to understand the basics of a plain deposit product, such as a savings account or low-balance checking account.

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Some banks may be willing to enter into an individual contract with the minor because the minor is very near the age of 18, or because of unique circumstances that led the bank to believe the minor will not misuse the account, or perhaps the situation is one that a minor faces the hardship of not having trustworthy adults in his/her life to assist the minor thus making a joint account or WUTMA account perilous.

If a bank decides to enter into an individual contract with a minor, bank should consider the risks associated with the contract and identify whether there are any features or products that may be used to minimize such risks. For example, given a particular minor's needs would a solely-owned savings account be sufficient, or if a checking account were established are there account parameters that can be set to limit overdraft liabilities or risks associated with an account compromise. Or if offering a debit card, could a daily limit be set lower than a normal daily limit.

If contracting with minors individually, banks should also consider what financial literacy resources can be made available to the minor as a way to help build a foundation of understanding and proper use of a deposit account, help the minor avoid potential scams, and to help build a long-lasting relationship with the minor.

Lending to Minors

Occasionally, over the years, WBA Legal has received questions of whether banks could lend to minors. The question typically arises when the minor wants their first car, or from a parent seeking "to establish credit" for the minor. Lending to a minor is not illegal, however, there is much to consider. Just as a minor may void liability under a deposit contract for the reasons outlined above, the same theory applies to credit contracts. As a result, lending to a minor individual can bear risk.

There is also the concern over whether the minor has the ability to repay the loan given that minors typically are still focused on schooling and building for future plans post high school. Obligating a minor for what may likely be a couple of years, with a monthly financial commitment is significant. There is also the social, more philosophic discussion of whether lending to someone under the age of 18 is helpful or harmful to the minor. Bank management should weigh the overall impact on a minor before establishing policy and procedures around lending to minors.

Summary

Several banking relationships can involve minors and each bank need consider whether and how it will contract with a minor. The decisions are often based upon risk given that minors can void liability of a contract due to the minor's age.

Some banks allow for joint accounts between minors and adults, others allow for WUTMA accounts, and others may be willing to enter into individual accounts with minors. Frontline banking staff should be aware of the bank's own policy so that the proper product can be selected.

If you have any questions on this topic or other matters of compliance, contact WBA's legal call program at 608-441-1200 or wbalegal@wisbank.com.

Recent Court Action Overturns Closed-End Loan HMDA Reporting Threshold for Exempt Institutions

In *National Community Reinvestment Coalition v. Consumer Financial Protection Bureau (CFPB)*, a D.C. District Court has invalidated the legal exemption threshold for reporting closed-end loan data for HMDA purposes. The ruling lowers the HMDA reporting threshold for closed-end mortgage loans.

CFPB has the authority to establish thresholds for reporting closed-end mortgage loan and open-end lines of credit HMDA data. In 2015, CFPB overhauled the existing HMDA data collection and reporting requirements. Upon determining that the existing rules for closed-end mortgage loans presented an administrative burden on lending institutions, CFPB promulgated a rule to exempt from the disclosure requirements those lending institutions issuing fewer than 25 closed-end mortgage loans. HMDA reporting thresholds were revised again in 2017 and in 2020.

In its 2020 rule, CFPB attempted to address "considerable burdens associated with reporting" HMDA data and set the threshold for exemption at 100 closed-end mortgage loans in each of the two preceding calendar years. The 2020 rule also set an exemption threshold for open-end lines of credit; which starting in 2022, is 200 open-end lines of credit in each of the two preceding calendar years.

The plaintiffs in the case challenged CFPB's 2020 rule claiming the agency (a) exceeded its statutory authority under HMDA when it set the closed-end reporting exemption threshold, and (b) was incorrect with its costs-benefit analysis under the belief CFPB exaggerated the "benefits" of increasing the loan-volume reporting thresholds and had miscalculated the "costs" of the 2015 rule.

The court concluded the plaintiffs accurately identified flaws in CFPB's 2020 rule's costs-benefit analysis the agency used to support the increase in closed-end mortgage loan thresholds. The court also found CFPB failed to respond appropriately to the comments questioning the magnitude of the estimated savings.

As a result, the court invalidated the exemption threshold for closed-end loans. The court vacated and remanded the closed-end mortgage loan reporting threshold to CFPB. The exemption threshold for open-end lines of credit remains untouched at 200 open-end lines of credit originated in each of the prior two years.

The effect of the court's findings rolls the exemption threshold for closed-end loans down from 100 to the 2015 level of 25 closed-end mortgage loans. WBA recommends that banks that expect to exceed the closed-end mortgage loan threshold of 25 closed-end mortgage loans in each of the two preceding calendar years begin HMDA reporting preparations now. WBA expects reporting obligations to resume for 2023 at the lower threshold. WBA believes CFPB is to issue instructions regarding how to comply with HMDA requirements for those affected by the ruling. WBA will share the instructions upon release.

The court ruling may be viewed at: https://www.citizen.org/wp-content/uploads/NCRC-v-CFPB-decision.pdf

Wisconsin Bankers Association

Compliance Journal

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Special Focus

Questions and Answers Regarding Minors and WUTMA Accounts: Part 1

WBA Legal frequently receives questions regarding contracting with minors. As a starting point, banks should understand that they may contract with minors. This includes both deposit accounts and loans. However, a minor can escape liability under the contract. Meaning, a minor could avoid liability from a bank seeking to hold a minor accountable for terms under the contract. Thus, banks are free to contract with minors, but must decide so as a matter of risk.

When it comes to minor accounts, WBA Legal generally recommends that banks consider the use of an account established under WUTMA as the Act provides rules under which a custodian is required to act and rights for the minor, such as when custodianship under WUTMA ends. This article, which is the first part of a two-part series, will answer the most frequently asked questions WBA Legal receives regarding WUTMA accounts. As such, the following Q&As will focus exclusively on deposit account relationships. Part two of this article series will address the topic of contracting with minors more globally, including the doctrine of incapacity and what banks should consider if lending to minors. The second article will run in next month's *WBA Compliance Journal*.

Question: What is WUTMA?

Answer: WUTMA stands for "Wisconsin Uniform Transfer to Minors Act" and can be found under Wisconsin Chapter 54 which can be accessed here: https://docs.legis.wisconsin.gov/statutes/statutes/54.pdf

A WUTMA account would be one which is created pursuant to Chapter 54.

WUTMA relates to certain irrevocable transfers of property to a minor, which is held by a custodian. Chapter 54 provides certain requirements, procedures, and responsibilities, which must be followed by the custodian. When an account is opened under WUTMA, bank should refer to its contract, as well as Chapter 54, to understand which rules apply to the relationship between the minor, the adult custodian, and the bank.

Question: What is the definition of "minor?"

Answer: For purposes of WUTMA, "minor" means an individual who has not attained the age of 21 years.

Question: What is the definition of "custodian?"

Answer: For purposes of WUTMA, a custodian is a person designated under Wis. Stat. section 54.870 or a successor or substitute custodian.

Generally speaking, a custodian is appointed when a transfer to a minor is made. This can be as simple as opening a WUTMA account and designating a custodian.

Special Focus

Question: How should a WUTMA account be titled?

Answer: [Minor's name] by [Custodian's name] as Custodian under WUTMA.

For example: Mary Minor by Andrew Adult as Custodian under WUTMA.

When an account is opened in such a manner, a transfer is made under Wis. Stat. section 54.870 and a custodian is appointed.

Question: What procedures should be followed when opening a WUTMA account?

Answer: Bank should have procedures in place specific to WUTMA considerations. Generally, those procedures will be similar to other custodial or fiduciary account relationships bank offers. However, banks should be familiar with Chapter 54, bank's contract, and procedures, regarding such accounts in order to understand the aspects which are specific to a WUTMA account. Many of those aspects are discussed in this article.

While being careful so as to not provide legal advice to customers, bank staff should also consider discussing with the custodian the significance of their duties and responsibilities under the bank's WUTMA account contract terms and WUTMA generally. Frequently, WBA Legal receives questions predicated upon the custodian not understanding WUTMA, their duties, or procedures which must be followed. Such situations may be avoided by discussing the nature of WUTMA accounts and what they entail during the account opening process.

Question: Is it possible to create a non-WUTMA custodial account for minors?

Answer: Yes.

Such an account would be created as a matter of contract. There is no statute to guide such accounts. Bank should work with its legal counsel for any questions related to such accounts.

Question: When should the funds in a WUTMA account be released to the minor?

Answer: It is the duty of the custodian to release the funds to the minor. Bank is not required under WUTMA to take any action on a WUTMA account when the minor turns 18, 21, or any age.

Specifically, pursuant to Wis. Stat. section 54.892, the liability for release of funds to the minor rests with the custodian. Bank's responsibility is to the terms of its contract, which is with the custodian. The custodian should take action when the minor turns 18 or 21, depending upon the type of custodial transfer.

Question: How should bank handle a situation where it suspects the custodian is in breach of their duty?

Answer: There is no clear procedure for such a situation. Bank will need to consider such matters on a case-by-case basis, and determine what action is appropriate.

Often, there may be situations where the custodian does not know, or understand, the requirements of Chapter 54. There may also be situations where the custodian is knowingly in breach of their duties. A custodian may also simply forget. While there is no one-size-fits-all solution to these situations, banks should be confident to ask questions

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of the custodian and gather information where appropriate. Once better informed, bank will need to decide how best to proceed based upon what it knows of the situation, and its policies and procedures.

Question: What if the minor makes inquiries or demands on a WUTMA account?

Answer: The custodian is the only proper party to act on a WUTMA account. This includes releasing funds or information.

Bank should consider that the minor has no contractual right to the account. Thus, any of the minor's inquiries or demands regarding the account should be directed to the custodian. If the custodian is unreachable, but the minor believes they are entitled to act on the account, they should work with an attorney to advise them on how to proceed. If bank decides to pursue other options, it must do so based upon its own policies and procedures.

This applies regardless of the age of the minor.

Question: Can non-WUTMA funds, such as a minor's payroll, be deposited into a WUTMA account?

Answer: It is generally inappropriate for a minor's payroll funds to be deposited in a WUTMA account. The reason being, WUTMA accounts are established to hold funds transferred under Chapter 54. Those funds should not be mixed with non-WUTMA funds, such as payroll, or other. Payroll is generally not considered a WUTMA transfer, but is income.

That said, it is generally the custodian's duty to determine how the WUTMA account should be managed. Bank may want to consider having a discussion with the custodian as to whether this type of deposit is appropriate and determine whether bank will permit such a practice. At minimum, bank should not allow the minor to conduct split deposits or negotiate payroll checks against the WUTMA account for the reasons outlined in the Q&A directly above.

Question: What happens when the custodian of a WUTMA account dies?

Answer: If the custodian dies, the procedure under Wis. Stat. 54.888 must be followed. That procedure can be found here: https://docs.legis.wisconsin.gov/statutes/statutes/54/vii/888

Generally speaking, this procedure involves the appointment of a successor custodian. Depending upon the situation, that procedure can change. Because the procedure can require the involvement of the courts, the easier solution is to have a successor custodian designated. For this reason, bank might consider asking a custodian whether they have a successor custodian when opening a WUTMA account. Bank should obtain the name and contact information of such a successor custodian.

Question: Can a minor be a POD beneficiary?

Answer: Yes.

When a minor is designated as a payable on death (POD) beneficiary, special considerations should be made. Wis. Stat. section 705.04(2)(f) requires that the funds in a POD account be paid to a minor in accordance with Chapter 54. Thus, if funds are to be paid out to a minor beneficiary, they must be made payable under WUTMA, which would require a custodian.

As a result, bank should indicate on its POD designation form that funds are payable to minors under WUTMA. Furthermore, bank should identify the custodian. Ideally, bank should also identify a successor custodian. Bank should also ensure it has a means to identify and contact the named custodian and successor custodian.

The following are examples for naming a minor as POD beneficiary:

For individual accounts: [Name of Minor], but if he/she is a minor on the date of my death, to [Name of Adult] as custodian for [Name of Minor] under WUTMA.

For joint accounts: [Name of Minor], but if he/she is a minor on the date of death of the last surviving depositor, to [Name of Adult] as custodian for [Name of Minor] under WUTMA.

While it is possible for a minor to be designated as a POD beneficiary, a WUTMA account cannot have a POD beneficiary designation made to the account for reasons outlined in the last Q&A below.

Question: Do protections exist for banks under Chapter 54?

Answer: Yes.

Wis. Stat. section 54.884 provides for exemptions of third persons from liability. A bank may, without court order, act on the instructions of the custodian. Bank must be acting in good faith, and without knowledge to the contrary of the custodian's authority.

Question: Can WUTMA accounts have fees?

Answer: Yes.

This is a matter of contract between bank and customer. There is nothing prohibiting fees on a WUTMA account. It will ultimately be a business decision as to whether bank charges fees on such an account. As with all fees, terms, and conditions, and because of WUTMA's general nature as a vehicle for savings, it is recommended that bank ensures disclosures are clear and known by the customer as to what fees may be charged.

Question: Can a WUTMA account have multiple custodians?

Answer: No.

See Wis. Stat. section 54.872.

Question: Can a WUTMA account have multiple minors?

Answer: No.

See Wis. Stat. section 54.872.

Question: Can a custodian appoint a POA to a WUTMA account?

Answer: Yes.

Pursuant to Wis. Stats. section 54.884, banks are permitted to follow the instructions of the custodian if the bank is acting in good faith and without knowledge and not in violation of a court order. This means that bank may generally permit the custodian to appoint an agent on the WUTMA account if the custodian so requests such appointment and so long as the appointment is not in violation of a court order.

Whether an agent of a custodian can act on the WUTMA account, refer to the custodian's POA agreement to determine whether the agent has authority to act on a WUTMA account.

Question: Is a WUTMA account subject to legal process, such as a levy?

Answer: Yes, assuming the minor is the party named in the legal process item.

Chapter 54 does not provide for exemptions from legal process. However, there could be other reasons legal process would not apply. As with all legal process, bank should confirm to whom and to which accounts the order applies. Based upon that, bank might consider following up with the plaintiff to explain that the funds are in a custodial account. Reason being, custodial funds, such as those transferred under WUTMA, release upon certain conditions, and it might be that they cannot yet be released. For example, if they're in a time deposit such as a CD, there are special rules regarding garnishment of a CD prior to maturity. A court order might be necessary stipulating when the funds are to be released. It might also be that the plaintiff simply releases those funds and seeks recovery elsewhere.

Question: What happens if the minor of a WUTMA account dies?

Answer: When a minor dies, the funds in a WUTMA account belong to the minor's estate. Bank should look to work with whomever has authority to act on behalf of the minor's estate to manage the funds. This may be the custodian, or another individual. Note that the custodian does not automatically have authority to act on behalf of the minor's estate. Thus, bank should follow its typical procedures upon a depositor's death in this situation.

See Wis. Stats. section 54.892(3).

Conclusion

These Q&As, which is the first part of a two-part series, encompass the most frequently asked questions WBA Legal receives regarding WUTMA accounts through the legal call program. While it was designed to be as comprehensive as possible, it does not cover all potential situations. As a result, banks should consider this article as a reference for a starting point. All situations should be evaluated as appropriate to the circumstances and bank's own policies and procedures.

In addition to the above Q&As, WBA Legal has created a WUTMA reference chart which follows this article. WBA Legal is also in the process of creating consumer-facing resources for banks to utilize in assisting their customers in understanding WUTMA accounts. The consumer-facing resources will be available by month's end and will be found on the consumer resources page of the WBA website, https://www.wisbank.com/resources/consumer-resources/

Part two of this article series will address the topic of contracting with minors more globally, including the doctrine of incapacity and what banks should consider if lending to minors. The second article will run in next month's *WBA Compliance Journal*.

If you have any questions regarding these Q&As, or other scenarios, don't hesitate to contact WBA Legal at 608-441-1200 or by email at wbalegal@wisbank.com.

Wisconsin Bankers Association

Compliance Journal

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Special Focus

Selected Interagency Flood Q&As

Recently, the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Farm Credit Administration, and National Credit Union Administration released revised Interagency Questions and Answers Regarding Flood Insurance (Interagency Q&As). The Interagency Q&As address frequently asked questions about the flood insurance requirements of the National Flood Insurance Act, as amended, and its accompanying regulation. While the Interagency Q&As do not represent a change in the rules or regulation, they do offer revised guidance on various aspects of the rule. This article presents selected Q&As based upon prominent flood insurance questions.

Summary

Topics addressed by the revisions include guidance related to major amendments to the flood insurance laws regarding the escrow of flood insurance premiums, the detached structure exemption, force placement procedures, and the acceptance of flood insurance policies issued by private insurers. With the issuance, the agencies have also updated and consolidated all previous Questions and Answers.

The Interagency Q&As are organized by category and broken down into numerical designations within their categories. The agencies plan to update and manage these categories accordingly in the future. The current categories are as follows:

I. Determining the Applicability of Flood Insurance Requirements for Certain Loans
II. Exemptions from the Mandatory Flood Insurance Purchase Requirements
III. Private Flood Insurance—Mandatory Acceptance
IV. Private Flood Insurance—Discretionary Acceptance
V. Private Flood Insurance—General Compliance
VI. Standard Flood Hazard Determination Form (SFHDF)
VII. Flood Insurance Determination Fees
VIII. Flood Zone Discrepancies
IX. Notice of Special Flood Hazards and Availability of Federal Disaster Relief
X. Determining the Appropriate Amount of Flood Insurance Required
XI. Flood Insurance Requirements for Construction Loans
XII. Flood Insurance Requirements for Residential Condominiums and Co-Ops
XIII. Flood Insurance Requirements for Home Equity Loans, Lines of Credit, Subordinate Liens, and Other Security Interests in Collateral Located in an SFHA
XIV. Requirement to Escrow Flood Insurance Premiums and Fees—General
XV. Requirement to Escrow Flood Insurance Premiums and Fees—Escrow Small Lender Exception XVI.
XVI. Requirement to Escrow Flood Insurance Premiums and Fees—Escrow Loan Exceptions
XVII. Force Placement of Flood Insurance
XVIII. Flood Insurance Requirements in the Event of the Sale or Transfer of a Designated Loan and/or Its Servicing Rights
XIX. Mandatory Civil Money Penalties

Selected Q&As

The Interagency Q&As were issued in seventy pages in the *Federal Register*. As such, it is not practical to reproduce the entire set of Q&As within this article. However, based upon recent flood insurance issues, and questions WBA receives through its Legal Call program, this article presents certain selected Q&As for consideration below. Banks are encouraged to review the entire Interagency Q&As as well, which may be viewed from the link included at the end of the article.

For ease of reference, the term "Act" in this article refers to the National Flood Insurance Act of 1968 and the Flood Disaster Protection Act of 1973, as revised by the National Flood Insurance Reform Act of 1994, Biggert-Waters Flood Insurance Reform Act of 2012, and Homeowner Flood Insurance Affordability Act of 2014 (codified at 42 U.S.C. 4001 et seq). "Regulation" refers to each agency's current flood regulation: 12 CFR 208.25 (Board); 12 CFR part 339 (FDIC); and 12 CFR part 22 (OCC).

Applicability

Section I of the Interagency Q&As discuss determining the applicability of flood insurance requirements for certain loans (APPLICABILITY).

APPLICABILITY 2 discusses a common situation which WBA is often asked through the Legal Call program. That is, some borrowers have buildings with limited utility or value, and, in many cases, the borrower would not replace them if lost in a flood. This Q&A indicates that lenders must require flood insurance on a building or mobile home when those structures are part of the property securing the loan and are located in an SFHA in a participating community, regardless of value. However, flood insurance is not required on a structure that is part of a residential property but is detached from the primary residential structure of such property and does not serve as a residence. If the limited utility or value structure does not qualify for the detached structure exemption, a lender may consider ''carving out'' the building from the security it takes on the loan to avoid having to require flood insurance on the structure. Meaning, a lender might consider disclaiming such collateral from the loan security. However, the lender should fully analyze the risks of this option. In particular, a lender should consider whether and how it would be able to market and sell the property securing its loan in the event of foreclosure.

APPLICABILITY 5 discusses that a lender's purchase from another lender of a loan secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act does not trigger any requirements under the Regulation. A lender's purchase of a loan, secured by a building or mobile home located in an SFHA in which flood insurance is available under the Act, alone, is not an event that triggers the Regulation's requirements, such as making a new flood determination or requiring a borrower to purchase flood insurance. Requirements under the Regulation are triggered when a lender makes, increases, extends, or renews a designated loan. A lender's purchase of a loan does not fall within any of those categories. However, if a lender becomes aware at any point during the life of a designated loan that flood insurance is required, the requirements of the Regulation apply, including force-placing insurance, if necessary. Depending on the circumstances, the lender may need to conduct due diligence for safety and soundness reasons, which could include determining whether flood insurance on purchased loans is required. Additionally, if the purchasing lender subsequently refinances, extends, increases, or renews a designated loan, it must comply with the Regulation.

APPLICABILITY 13 discusses "triggering events" and what is required upon the occurrence of a "triggering event." Under the Regulation, a triggering event occurs when

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a designated loan is made, increased, extended, or renewed (also known as a "MIER" or "MIRE" event). If a triggering event occurs with respect to a designated loan, the lender must comply with the Regulation as applicable, including the mandatory flood insurance purchase requirement, the requirement to provide the Notice of Special Flood Hazards to the borrower, the requirement to notify the Administrator of the Federal Emergency Management Agency (FEMA) or the Administrator's designee (the insurance provider) in writing of the identity of the servicer of the loan, and the requirement to escrow for a loan secured by residential property, unless either the lender or the loan qualifies for an exception. Examples of events that are not considered triggering events for purposes of the Regulation include: the purchase of a loan from another lender (see above); a loan restructuring or modification that does not increase the amount of the loan nor extend or renew the terms of the loan (see Q&A APPLICABILITY 6); the assumption of the loan by another borrower; the remapping of a building securing the loan into an SFHA; the acquisition by a lender of an interest in a loan either by participation or syndication (see Q&A APPLICABILITY 9); a cashless roll (see Q&A APPLICABILITY 10); certain automatic extensions of credit (see Q&A APPLICABILITY 11); and certain treatments of force placement premiums.

Exceptions

Section II of the Interagency Q&As discusses exemptions from the mandatory flood insurance purchase requirements (EXEMPTIONS).

<u>EXEMPTIONS 1</u> summarizes the only three exemptions from the mandatory requirement to purchase flood insurance on a designated loan. The first applies to State-owned property covered under a policy of self-insurance satisfactory to the Administrator of FEMA. The second applies if both the original principal balance of the loan is $5,000 or less, and the original repayment term is one year or less. The third applies to any structure that is a part of any residential property but is detached from the primary residential structure of such property and does not serve as a residence. For purposes of the detached structure exemption, a "structure that is a part of residential property" is a structure used primarily for personal, family, or household purposes, and not used primarily for agricultural, commercial, industrial, or other business purposes. In addition, a structure is "detached" from the primary residential structure if it is not joined by any structural connection to that structure. Furthermore, whether a structure "does not serve as a residence" is based upon the good faith determination of the lender that the structure is not intended for use or actually used as a residence, which includes sleeping, bathroom, or kitchen facilities.

<u>EXEMPTIONS 2</u> discusses whether a lender must take a security interest in the primary residential structure for detached structures to be eligible for the detached structure exemption. For example, suppose the house on a farm is not collateral, but all of the outbuildings including the barn, the equipment storage shed, and the silo (which are used for farm production), and a detached garage where the homeowner keeps his car, are taken as collateral. In this case, the lender does not have to take a security interest in the primary residential structure for detached structures to be eligible for the exemption, but the lender needs to evaluate the uses of detached structures to determine if they are eligible. The term "a structure that is part of a residential property" in the detached structure exemption applies only to structures for which there is a residential use and not to structures for which there is a commercial, agricultural, or other business use. In this example, only the garage is serving a residential use, so it could qualify for the exemption. The barn, equipment storage shed, and silo, which are used for farm production, would not qualify for the exemption.

Determining the Appropriate Amount of Flood Insurance

Section X of the Interagency Q&As provides guidance for determining the appropriate amount of flood insurance required (AMOUNT). Generally speaking, the minimum amount of flood insurance required must be at least equal to the lesser of the outstanding principal balance of the loan, the maximum amount available under the National Flood Insurance Program (NFIP) for the type of structure, or the insurable value of the property. Section X helps to clarify these concepts through various Q&As.

When receiving calls through the WBA Legal Call program, WBA is most frequently asked how to calculate flood insurance. As such, the selected questions and answers from the AMOUNT section will focus on calculations.

<u>AMOUNT 1</u> discusses what is meant by the "maximum limit of coverage available." In part, the guidance provides that the maximum limit of coverage available for the particular type of property under the Act depends on the value of the secured collateral. First, under the NFIP, there are maximum caps on the amount of insurance available for buildings

located in a participating community under the Regular Program. In addition to the maximum caps under the NFIP, the Regulation also provides that "flood insurance coverage under the Act is limited to the building or mobile home and any personal property that secures a loan and not the land itself," which is commonly referred to as the "insurable value" of a structure.

An NFIP policy will not cover an amount exceeding the "insurable value" of the structure, so the maximum amount of insurance coverage is the applicable limit available under the NFIP or the insurable value, whichever is less. In determining coverage amounts for flood insurance, lenders often follow the same practice used to establish other hazard insurance coverage amounts. However, unlike the insurable valuation used to underwrite most other hazard insurance policies, the insurable value of improved real estate for flood insurance purposes also includes the repair or replacement cost of the foundation and supporting structures. It is very important to calculate the correct insurable value of the property; otherwise, the lender might inadvertently require the borrower to purchase too much or too little flood insurance coverage. For example, if the lender fails to exclude the value of the land when determining the insurable value of the improved real estate, the borrower will be asked to purchase coverage that exceeds the amount the NFIP will pay in the event of a loss.

AMOUNT 2 provides further clarification on the definition of "insurable value." The insurable value of the building may generally be the same as 100 percent Replacement Cost Value, which is the cost to replace the building with the same kind of material and construction without deduction for depreciation. In calculating the amount of insurance to require, the lender and borrower (either by themselves or in consultation with the flood insurance provider or other appropriate professional) may choose from a variety of approaches or methods to establish the insurable value. They may use an appraisal based on a cost-value (not market-value) approach, a construction cost calculation, the insurable value used on a hazard insurance policy (recognizing that the insurable value for flood insurance purposes may differ from the coverage provided by the hazard insurance and that adjustments may be necessary), the replacement cost value listed on the flood insurance policy declarations page, or any other reasonable approach, so long as it can be supported.

AMOUNT 5 provides an example of how to calculate the amount of insurance required. As discussed above, the amount of insurance required by the Act and Regulation is the lesser of:

- The outstanding principal balance of the loan(s); or
- The maximum amount of insurance available under the NFIP, which is the lesser of:
    - The maximum limit available for the type of structure; or
    - The "insurable value" of the structure.

Example: (Calculating insurance required on a non-residential building): Loan security includes one equipment shed located in an SFHA in a participating community under the Regular Program.

- Outstanding loan principal balance is $300,000.
- Maximum amount of insurance available under the NFIP:
    - Maximum limit available for type of structure is $500,000 per building (non-residential building).
    - Insurable value of the equipment shed is $30,000.

The minimum amount of insurance required by the Regulation for the equipment shed is $30,000.

AMOUNT 6 covers another frequently asked question, that being: how does one calculate flood insurance when multiple buildings securing the loan are located in a SFHA? In such cases, the lender must determine the amount of insurance required on each building and add these individual amounts together. The total amount of required flood insurance is the lesser of:

- The outstanding principal balance of the loan(s); or
- The maximum amount of insurance available under the NFIP, which is the lesser of:
    - The maximum limit available for the type of structures; or
    - The "insurable value" of the structures. The amount of total required flood insurance can be allocated among the secured buildings in varying amounts, but all buildings in an SFHA must be covered in accordance with the statutory requirement.

Example: Lender makes a loan in the principal amount of $150,000 secured by five non-residential buildings, only three of which are located in SFHAs within participating communities.

- Outstanding loan principal is $150,000.
- Maximum amount of insurance available under the NFIP.
    - Maximum limit available for the type of structure is $500,000 per building for non-residential buildings (or $1.5 million total); or
    - Insurable value ($100,000 for each non-residential building for which insurance is required, or $300,000 total). Amount of insurance required for the three buildings is $150,000. This amount of required flood insurance could be allocated among the three buildings in varying amounts, so long as each is covered in accordance with the statutory requirement.

In addition to the above, the AMOUNT section provides examples of residential buildings, non-residential buildings (both of which are important for determining the maximum caps on the amount of insurance available), mixed-use properties, and acceptance of blanket policies, among others. Refer to the final Q&A (link provided below) to review the entire section.

Other Security Interests

WBA is frequently asked whether the contents of a building require flood insurance and, if so, how much. Section XIII of the Interagency Q&As discuss flood insurance requirements for home equity loans, lines of credit, subordinate liens, and other security interests in collateral (contents) located in a SFHA (OTHER SECURITY INTERESTS). The following Q&As have been selected specific to contents coverage.

OTHER SECURITY INTERESTS 6 provides that if the loan request is to finance inventory stored in a building located within an SFHA, but the building is not security for the loan, flood insurance is not required. This is because the Act and the Regulation provide that a lender shall not make, increase, extend, or renew a designated loan, that is, a loan secured by a building or mobile home located or to be located in an SFHA, ‘‘unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan.’’ In this example, the loan is not a designated loan because it is not secured by a building or mobile home; rather, the collateral is the inventory alone.

OTHER SECURITY INTERESTS 7 discusses that flood insurance is required however if a building and its contents both secure a loan, and the building is located in an SFHA in which flood insurance is available. In this case, flood insurance is required for the building located in the SFHA and any personal property securing the loan. The method for allocating flood insurance coverage among multiple buildings, as described in Q&A AMOUNT 6 (which appears in this article, above), would be the same method for allocating flood insurance coverage among contents and buildings. That is, both contents and building will be considered to have a sufficient amount of flood insurance coverage for regulatory purposes so long as some reasonable amount of insurance is allocated to each category.

Example: Lender A makes a loan for $200,000 that is secured by a warehouse with an insurable value of $150,000 and inventory in the warehouse worth $100,000. The Act and Regulation require that flood insurance coverage be obtained for the lesser of the outstanding principal balance of the loan or the maximum amount of flood insurance that is available under the NFIP. The maximum amount of insurance that is available for both building and contents is $500,000 for each category. In this situation, Federal flood insurance requirements could be satisfied by placing $150,000 worth of flood insurance coverage on the warehouse, thus insuring it to its insurable value, and $50,000 worth of contents flood insurance coverage on the inventory, thus providing total coverage in the amount of the outstanding principal balance of the loan. Note that this holds true even though the inventory is worth $100,000.

OTHER SECURITY INTERESTS 8 provides that if a loan is secured by Building A, which is located in an SFHA, and contents located in Building B where building B does not secure the loan, flood insurance is not required on the contents securing the loan.

OTHER SECURITY INTERESTS 10 provides that flood insurance is required if the lender takes a security interest in contents located in a building in an SFHA securing the loan, regardless of whether the lender perfects its security interest.

Resources

WBA has identified other helpful resources regarding flood insurance requirements. Through FRB's asktheFed® program, FRB hosted a webinar in late July regarding the Interagency Q&As. The webinar replay had not yet been posted at the time of this article; however, banks should monitor for the posting as the webinar is a helpful overview of the revised guidance. Past webinars may be found online after logging into the website: https://bsr.stlouisfed.org/askthefed/Auth/Logon

Also, in the second issue 2022 of FRB's *Consumer Compliance Outlook*, FRB addressed common pitfalls in commercial flood insurance compliance. The resource may be viewed at: https://consumercomplianceoutlook.org/

The complete Interagency Q&As may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-05-31/pdf/2022-10414.pdf

Conclusion

While the flood insurance rules themselves have not changed, the Interagency Q&As revise and consolidate helpful guidance into a single document. There are many additional Q&As within the final issuance, including three new sections dedicated to Q&As regarding private flood insurance. The items selected above are based upon the most frequently asked questions WBA receives through its Legal Call program. If bank has an issue that is not discussed above, it should consider consulting the Interagency Q&As to see if the question is addressed there. Banks should also not hesitate to reach out to WBA directly for assistance on flood insurance matters at wbalegal@wisbank.com and 608-441-1200.

FDIC Issues Supervisory Guidance on Multiple Re-Presentment NSF Fees

The Federal Deposit Insurance Corporation (FDIC) issued new guidance to ensure that supervised institutions are aware of the consumer compliance risks associated with assessing multiple nonsufficient funds (NSF) fees arising from the re-presentment of the same unpaid transaction. Additionally, FDIC shares its supervisory approach where a violation of law is identified and full corrective action is expected.

Background

Many financial institutions charge NSF fees when checks or Automated Clearinghouse (ACH) transactions are presented for payment but cannot be covered by the balance in a customer's transaction account. After receiving notice of declination, merchants may subsequently resubmit the transaction for payment. Some financial institutions charge additional NSF fees for the same transaction when a merchant re-presents a check or ACH transaction on more than one occasion after the initial unpaid transaction was declined. In these situations, FDIC stated there is an elevated risk of violations of law and harm to consumers.

During consumer compliance examinations, FDIC has identified violations of law when financial institutions charged multiple NSF fees for the re-presentment of unpaid transactions. FDIC found that some disclosures provided to customers did not fully or clearly describe the institution's re-presentment practice, including not explaining that the same unpaid transaction might result in multiple NSF fees if an item was presented more than once.

Potential Risks Arising from Multiple Re-Presentment NSF Fees

<u>Consumer Compliance Risk</u>
FDIC has stated practices involving the charging of multiple NSF fees arising from the same unpaid transaction results in heightened risks of violations of Section 5 of the Federal Trade Commission (FTC) Act and Section 1036(a)(1)(B) of the Dodd Frank Act which prohibit unfair, deceptive, and abusive acts or practices (UDAAP). While specific facts and circumstances ultimately determine whether a practice violates a law or regulation, FDIC stated the failure to disclose material information to customers about re-presentment and fee practices has the potential to mislead reasonable customers. FDIC also stated there are situations that may also present risk of unfairness if the customer is unable to avoid fees related to re-presented transactions.

- <u>Deceptive Practices</u>: In a number of consumer compliance examinations, FDIC determined that if a financial institution assesses multiple NSF fees arising from the same transaction, but disclosures do not adequately advise customers of this practice, the misrepresentation and omission of the information from the institution's disclosures is material. FDIC found that if the information is not disclosed clearly and conspicuously to customers, the material omission of the information is considered to be deceptive pursuant to Section 5 of the FTC Act.

- <u>Unfair Practices</u>: In certain circumstances, a failure to adequately advise customers of fee practices for re-presentments raises unfairness concerns because the practices may result in substantial injuries to customers; the injury may not be reasonably avoidable; and there may be no countervailing benefits to either customers or competition. In particular, FDIC stated a risk of unfairness may be present if multiple NSF fees are assessed for the same transaction in a short period of time without sufficient notice or opportunity for customers to bring their account to a positive balance in order to avoid the assessment of additional NSF fees. While revising disclosures may address the risk of deception, doing so may not fully address the unfairness risks.

<u>Third-Party Risk</u>
Third parties, including core processors, often play significant roles in processing payments, identifying and tracking re-presented items, and providing systems that determine when NSF fees are assessed. Such third-party arrangements may present risks if not properly managed. FDIC stated institutions are expected to maintain adequate oversight of third-party activities and appropriate quality control over products and services provided through third-party arrangements. Institutions should be sure to review past FDIC third-party vendor management guidance; see FIL-44-2008, Guidance for Managing Third-Party Risk, June 6, 2008.

In addition, FDIC stated institutions are responsible for identifying and controlling risks arising from third-party relationships to the same extent as if the third-party activity was handled within the institution. Institutions are encouraged to review and understand the risks presented from their core processing system settings related to multiple NSF fees, as well as understand the capabilities of their core processing system(s), such as identifying and tracking re-presented items and maintaining data on such transactions.

Litigation Risk:
The supervisory guidance also addressed litigation risk. Multiple NSF fee practices may result in heightened litigation risk. Numerous financial institutions, including some FDIC-supervised institutions, have faced class action lawsuits alleging breach of contract and other claims because of the failure to adequately disclose re-presentment NSF fee practices in their account disclosures. Some of the cases have resulted in substantial settlements, including customer restitution and legal fees.

Risk Mitigation Practices

FDIC has also provided a listing of risk mitigation practices that institutions are encouraged to review regarding the charging of NSF fees for re-presented transactions. FDIC has observed various risk-mitigating activities that financial institutions have taken to reduce the potential risk of consumer harm and avoid potential violations of law regarding multiple re-presentment NSF fee practices. These include:

- Eliminating NSF fees.
- Declining to charge more than one NSF fee for the same transaction, regardless of whether the item is re-presented.
- Conducting a comprehensive review of policies, practices, and monitoring activities related to re-presentments and making appropriate changes and clarifications, including providing revised disclosures to all existing and new customers.
- Clearly and conspicuously disclosing the amount of NSF fees to customers and when and how such fees will be imposed, including:
    - Information on whether multiple fees may be assessed in connection with a single transaction when a merchant submits the same transaction multiple times for payment;
    - The frequency with which such fees can be assessed; and
    - The maximum number of fees that can be assessed in connection with a single transaction.
- Reviewing customer notification or alert practices related to NSF transactions and the timing of fees to ensure customers are provided with an ability to effectively avoid multiple fees for re-presented items, including restoring their account balance to a sufficient amount before subsequent NSF fees are assessed.

The new guidance also sets forth steps FDIC recommends if an institution has self-identified re-presentment NSF fees issues. In such a case, FDIC expects supervised financial institutions to:

- Take full corrective action, including providing restitution to harmed customers, consistent with the restitution approach described in this guidance;
- Promptly correct NSF fee disclosures and account agreements for both existing and new customers, including providing revised disclosures and agreements to all customers;
- Consider whether additional risk mitigation practices are needed to reduce potential unfairness risks; and
- Monitor ongoing activities and customer feedback to ensure full and lasting corrective action.

FDIC's Supervisory Approach

When exercising supervisory and enforcement responsibilities regarding multiple representment NSF fee practices, FDIC stated it will take appropriate action to address consumer harm and violations of law. FDIC's supervisory response will focus on identifying re-presentment related issues and ensuring correction of deficiencies and remediation to harmed customers.

In reviewing compliance management systems, FDIC stated it recognizes an institution's proactive efforts to self-identify and correct violations and that examiners will generally not cite UDAAP violations that have been self-identified and fully corrected prior to the start of a consumer compliance examination. In addition, in determining the scope of restitution, FDIC stated it will consider an institution's record keeping practices and any challenges an institution may have with retrieving, reviewing, and analyzing re-presentment data, on a case-by-case basis, when evaluating the time period institutions utilized for customer remediation.

FDIC stated that in recent examinations, it has identified instances where institutions have been unable to reasonably access accurate ACH data for re-presented transactions beyond two years. In such cases, FDIC stated it has accepted a two-year lookback period for restitution. FDIC stated it expects supervised institutions to promptly address the issue. Institutions with challenges readily accessing accurate ACH data that self-correct and provide restitution to harmed customers, as appropriate, for transactions occurring two years before the date of FDIC's new supervisory guidance will generally be considered as having made full corrective action.

Lastly, FDIC stated that failing to provide restitution for harmed customers when data on re-presentments is reasonably available will not be considered full corrective action. If examiners identify violations of law due to re-presentment NSF fee practices that have not been self-identified and fully corrected prior to a consumer compliance examination, FDIC stated it will evaluate appropriate supervisory or enforcement actions, including civil money penalties and restitution, where appropriate.

Conclusion

FDIC has shared its supervisory approach when in review of account disclosures and compliance management systems for financial institutions that assess multiple NSF fees arising from the re-presentment of the same unpaid transaction. The guidance includes specific instruction for institutions should a re-presentment NSF fee issue be identified by the institution. While the Federal Reserve and OCC have not issued specific re-presentment guidance, all bank supervisory agencies have previously stated an interest in continued review of overdraft practices and programs. As a result, regardless of regulator, all banks need carefully review account disclosures and compliance management systems to ensure bank practice matches bank disclosure to protect against regulatory scrutiny and litigation risk. FDIC-supervised institutions need take the guidance into consideration, as applicable. The guidance may be viewed at: https://www.fdic.gov/news/financial-institution-letters/2022/fil22040.html

Wisconsin Bankers Association

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Special Focus

Overview of Latest Interagency Community Reinvestment Act Proposal

On June 3, 2022, 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 joint proposed rule (Proposal) to revise existing Community Reinvestment Act (CRA) regulations. The Proposal is meant to update how CRA activities qualify for consideration, where CRA activities are considered, and how CRA activities are evaluated. The Proposal comes after much advocacy by Wisconsin bankers and the WBA for a jointly-issued uniform rule between the Agencies.

The Proposal is substantial and includes 180 specific questions for which the Agencies seek feedback in preparation for a final rule. The following is an overview of the Proposal broken down by section. The overview does not cover every nuance of the Proposal, so for more details regarding a particular section, please review the Proposal itself. A link to the proposed rule is included at the end of this article.

Proposal Section III: Community Development Definitions.

Under the current CRA regulations and the Proposal, a bank may, depending on its size, be evaluated for its community development lending, investments, and/or services under various tests. The activities must have community development as their primary purpose. Community development activities currently fall into four broad categories: affordable housing; community services; economic development; and revitalization and stabilization.

The Agencies have proposed to review the community development definitions in order to clarify eligibility criteria for different community development activities by including eleven categories that establish specific eligibility standards for a broad range of community development activities. The new definitions incorporate some aspects of guidance that are currently provided in the Interagency CRA Questions and Answers. The proposed definitions reflect an emphasis on activities that are responsive to community needs, especially the needs of low- and moderate-income individuals and communities and small businesses and small farms.

Section III discusses proposed definitions for community development activities, including: affordable housing; economic development that supports small businesses and small farms; community supportive services; revitalization activities; essential community facilities; essential community infrastructure; recovery activities in designated disaster areas; disaster preparedness and climate resiliency activities; activities with minority depository institutions (MDIs), women's depository-institutions (WDIs), low-income credit unions (LICUs), and Community Development Financial Institutions (CDFIs) certified by the Department of the Treasury, referred to as Treasury Department-certified CDFIs; financial literacy; and qualifying activities in Native Land Areas. The Agencies propose using a primary purpose standard for determining eligibility of the above activities, with pro rata consideration for certain affordable housing activities. The Proposal provides background and current approach information for each of the above activities. Specific questions to each activity are embedded in the section to correspond to each activity for which the Agencies seek feedback thereon.

Proposal Section IV: Qualifying Activities Confirmation and Illustrative List of Activities.

Currently, as part of CRA examinations, banks submit community development activities that were undertaken without an assurance the activities are eligible. Knowing that an activity previously qualified can frequently provide banks with some confidence that the same types of activities are likely to receive consideration in the future. However, new, less common, more complex, or innovative activities might require examiner judgment and the use of performance context to determine whether an activity qualifies for CRA purposes. As a result, banks might know only at the end of an examination—and after a loan or investment has been made or a service provided—whether an activity will receive CRA credit.

To provide additional certainty in determining what community development activities qualify, the Agencies have proposed maintaining a publicly available illustrative, non-exhaustive list of activities eligible for CRA consideration. The Agencies also propose including a process for modifying the illustrative list of activities periodically. In addition, the Agencies have proposed a process, open to banks, for confirming eligibility of qualifying community development activities. These concepts are further discussed in Section IV of the Proposal.

Proposal Section V: Impact Review of Community Development Activities.

The Agencies' current qualitative assessment of a bank's community development performance takes into account the extent to which a bank's community development activities are innovative and complex. In addition, the Agencies consider whether a bank's activities reflect leadership and are responsive to community needs. These terms are generally defined in the Interagency CRA Questions and Answers, and guidance explains that an examiner will consider both quantitative and qualitative aspects of a bank's community development activities.

While current guidance emphasizes the importance of a qualitative review of a bank's community development activities and recognizes that certain activities are more responsive than others, there are no clear standards for how these factors are measured. As a result, the evaluation relies heavily on examiner judgment.

Section V describes the Agencies' proposed specific impact review factors to inform the impact and responsiveness evaluation of a bank's activities under the Community Development Financing Test, the Community Development Services Test, and the Community Development Financing Test for Wholesale or Limited Purpose Banks.

Proposal Section VI: Assessment Areas and Areas for Eligible Community Development Activity.

The Agencies have proposed to update the CRA assessment area approach to evaluate performance in facility-based assessment areas for all banks, and in retail lending assessment areas for large banks. The updates are intended to comprehensively establish the local communities in which a bank is evaluated for its CRA performance and to reflect ongoing changes to the banking industry. In addition, the Agencies propose to consider qualifying community development activities outside of a bank's assessment areas at the state, multistate MSA, and institution levels to add certainty and to encourage qualifying activities in areas with high community development needs.

Section VI describes what the Agencies have proposed regarding delineating facility-based assessment areas for main offices, branches, and deposit-taking remote service facilities (including ATMs). Under the Proposal, large banks would delineate assessment areas comprised of full counties, metropolitan divisions, or MSAs. Intermediate and small banks could continue to delineate partial county facility-based assessment areas, consistent with current practice.

Section VI also describes what the Agencies have proposed for large banks to delineate retail lending assessment areas where a bank has concentrations of home mortgage and/or small business lending outside of its facility-based assessment areas. Under the Proposal, a large bank would delineate retail lending assessment areas where it has an annual lending volume of at least 100 home mortgage loan originations or at least 250 small business loan originations in an MSA or nonmetropolitan area of a state for two consecutive years.

Section VI also discusses that the Agencies have proposed to allow banks to receive CRA credit for any qualified community development activity, regardless of location, although performance within facility-based assessment areas would be emphasized.

In connection with the concepts set forth in this section, Section X (as outlined below) also discusses the Agencies' desire to evaluate large banks and certain intermediate banks on their retail loans that are outside of both retail lending assessment areas and facility-based assessment areas, to ensure that retail lending evaluations for these banks are comprehensive.

Proposal Section VII: Performance Tests, Standards, and Ratings in General.

Section VII describes the Agencies' proposed evaluation framework, tailored for differences in bank size and business model. The Agencies have proposed the following four tests for large banks: Retail Lending Test; Retail Services and Products Test; Community Development Financing Test; and Community Development Services Test.

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Intermediate banks would be evaluated under the Retail Lending Test and the status quo Community Development Test, unless they choose to opt into the Community Development Financing Test. Small banks would be evaluated under the status quo Small Bank Lending Test, unless they choose to opt into the Retail Lending Test. Wholesale and limited purpose banks would be evaluated under a tailored version of the Community Development Financing Test.

Under the proposed framework, large banks would be banks that had average quarterly assets, computed annually, of at least $2 billion in both of the prior two calendar years; intermediate banks would be banks that had average quarterly assets, computed annually, of at least $600 million in both of the prior two calendar years and less than $2 billion in either of the prior two calendar years; and small banks would be banks that had average quarterly assets, computed annually, of less than $600 million in either of the prior two calendar years.

The Agencies are in the process of seeking approval from Small Business Administration (SBA) to use the $600 million threshold, where applicable and adjusted annually for inflation, rather than the SBA's recently updated size standards.

The Agencies have also proposed to further tailor aspects of the Proposal within the large bank category. The Agencies have proposed that certain provisions of the Retail Services and Products Test and Community Development Services Test would apply only to large banks that had average quarterly assets, computed annually, of over $10 billion in both of the prior two calendar years. These banks are referred to in the Proposal as large banks with assets of over $10 billion. Large banks that had average quarterly assets, computed annually, of $10 billion or less in either of the prior two calendar years are referred to in the Proposal as large banks with assets of $10 billion or less.

Section VII also discusses a new proposed definition of "operations subsidiary" to FRB's CRA regulation and "operating subsidiary" for FDIC's and OCC's CRA regulations (referred to collectively in the Proposal as "bank subsidiaries") to identify those bank affiliates whose activities would be required to be attributed to a bank's CRA performance. The Agencies have proposed to maintain the current flexibilities that would allow a bank to choose to include or exclude the activities of other bank affiliates that are not considered "bank subsidiaries."

Section VII also discusses performance context, and the requirement that a bank's CRA lending, investment, and service activities must be consistent with safe and sound banking practices, including underwriting standards.

Proposal Section VIII: Retail Lending Test Product Categories and Major Product Lines.

The Agencies have proposed to update the definitions for certain retail lending products, to clarify the evaluation of automobile lending, to aggregate certain retail loan types for evaluation, and to develop a clear quantitative threshold for determining when to evaluate a retail product line under the Retail Lending Test.

Specifically, the Agencies seek to improve transparency and streamline retail lending evaluations by:

- Aggregating, respectively, all closed-end home mortgage loans, all open-end home mortgage loans, and all multi-family loans as separate product lines for the purposes of evaluation under the Retail Lending Test.
- Adding definitions of small business and small farm that align with CFPB's proposed small business definition in its current rulemaking pursuant to section 1071 of the Dodd-Frank Act to minimize burden.
- Evaluating automobile lending using metrics in recognition of its importance to low- and moderate-income borrowers and communities.
- Establishing a clear major product line threshold of 15 percent of the dollar value of a bank's retail lending in each facility-based assessment area (and, as applicable, in each retail lending assessment area and in its outside retail lending area) to determine whether to evaluate, respectively, closed-end home mortgage, open-end home mortgage, multi-family, small business, and small farm lending under the Retail Lending Test.
- Establishing a major product line threshold for automobile lending of 15 percent based on the average of the percentage of automobile lending retail lending dollars out of total retail lending dollars and percentage of automobile loans by loan volume out of total retail lending by loan volume.

Proposal Section IX: Retail Lending Test Evaluation Framework for Facility-Based Assessment Areas and Retail Lending Assessment Areas.

This section of the Proposal discusses the proposed Retail Lending Test for standardizing evaluations of retail lending performance in facility-based assessment areas and retail lending assessment areas for large and intermediate banks. The Agencies have proposed using a retail lending volume screen to evaluate a bank's retail lending volumes. The Agencies also propose to evaluate a bank's major product lines using two distribution metrics that measure the bank's record of lending in low- and moderate-income census tracts and to borrowers of different income or revenue levels. Further, the Agencies propose to establish a standardized methodology for setting performance expectations for specific product lines. The methodology defines performance ranges for each conclusion category for each product, and this performance is then averaged together.

Through the metrics and thresholds, the Agencies propose to assign a score reflecting performance on each of a bank's major product lines in each assessment area and outside retail lending area, as applicable. For example, under the Proposal, a bank may receive a score reflecting its closed-end home mortgage lending performance and a different score for its small business lending performance in a facility-based assessment area, providing transparency at the product-line level and showing more granularly how a bank is serving the credit needs of its communities. The scores across the various major product lines would be combined to determine a recommended Retail Lending Test conclusion for each assessment area, weighted by the dollar volume associated with each product line. The aggregation would allow strong performance in one product line to potentially offset weaker performance in another product line.

Section IX sets forth various formulas including several benchmarks, market and community multipliers, and additional factors that may not be captured in metrics.

Proposal Section X: Retail Lending Test Evaluation Framework for Retail Lending Test Conclusions in State, Multistate MSAs, and at the Institution Level.

The Agencies have proposed a transparent and standardized approach to determining Retail Lending Test conclusions at the state, multistate MSA, and institution level. The proposed approach would leverage performance in a bank's local assessment areas. In addition, the Agencies also propose evaluating a large bank's retail lending performance in areas outside of its assessment areas, referred to as the outside retail lending area. This approach is intended to complement the proposed retail lending assessment areas, as described in Section VI above. The Agencies propose a tailored application of this approach for intermediate banks. Specifically, the Agencies have proposed evaluating an intermediate bank's retail lending performance outside of its facility-based assessment areas only if it does more than 50 percent of its lending outside of its facility-based assessment areas.

As summarized in Section VI above, the Agencies recognize that changing technology increasingly allows banks to reach consumers with loans and deposit products without any in-person contact at a branch office. As a result, a bank's lending may be geographically dispersed, without concentrations in particular local markets that would be captured by the proposed retail lending assessment areas. Tables of data included in the Proposal demonstrate the Agencies' estimates regarding activities for which assumptions within the Proposal have been based upon. For example, as shown in Table 1 in Section VI, the Agencies estimate that approximately 11 percent of home mortgage loans and 16 percent of small business loans originated by large banks would fall outside of facility-based assessment areas or the proposed retail lending assessment areas.

See this section of the Proposal for more details regarding each level of the Retail Lending Test, evaluations, and assigned conclusions.

Proposal Section XI: Retail Services and Products Test.

Section XI describes what the Agencies have proposed to evaluate large banks under the Retail Services and Products Test. The test would use a predominantly qualitative approach, incorporating quantitative measures as guidelines, as applicable. First, the delivery systems part of the proposed test seeks to achieve a balanced evaluation framework that considers a bank's branch availability and services, remote service facility availability, and its digital and other delivery systems. The Agencies propose that the evaluation of digital and other delivery systems and deposit products would be required for large banks with assets of over $10 billion, and not required for large banks with assets of $10 billion or less.

Second, the credit and deposit products part of the proposed test aims to evaluate a bank's efforts to offer products that are responsive to the needs of low- and moderate-income communities. The Agencies propose that the evaluation of deposit products responsive to the needs of low- or moderate-income individuals would be required for large banks with assets of over $10 billion, and not required for large banks with assets of $10 billion or less.

Proposal Section XII: Community Development Financing Test.

Section XII describes what the Agencies propose for the Community Development Financing Test, which would apply to large banks as well as intermediate banks that choose to opt into this test. The Community Development Financing Test would consist of a community development financing metric, benchmarks, and an impact review. These components would be assessed at the facility-based assessment area, state, multistate MSA and institution levels, and would inform conclusions at each of those levels.

The bank community development financing metrics would measure the dollar value of a bank's community development loans and community development investments together, relative to the bank's capacity, as reflected by the dollar value of deposits. The Agencies have proposed to use the term "community development investment" in place of the current term "qualifying investment" for clarity and consistency purposes. The proposed benchmarks would reflect local context, including the amount of community development financing activities by other banks in the assessment area, and would be used in conjunction with the metrics to assess the bank's performance. The metrics and benchmarks would be consistent across banks and Agencies and would provide additional clarity about the evaluation approach.

The impact review would evaluate the impact and responsiveness of a bank's community development loan and community development investment activities through the application of a series of specific qualitative factors described in more detail in Section V of the Proposal. The impact review would provide appropriate recognition under the Community Development Financing Test of activities that are considered to be especially impactful and responsive to community needs, including activities that may be relatively small in dollar amounts.

Proposal Section XIII: Community Development Services Test.

This section describes the Agencies' recommended plan to assess a large bank's community development services, underscoring the importance of the activities for fostering partnerships among different stakeholders, building capacity, and creating the conditions for effective community development. The Agencies propose that in nonmetropolitan areas, banks may receive community development services consideration for volunteer activities that meet an identified community development need, even if unrelated to the provision of financial services. The proposed test would consist of a primarily qualitative assessment of the bank's community development service activities. For large banks with assets of over $10 billion, the Agencies have proposed also using a metric to measure the hours of community development services activity per full time employee of a bank.

Proposal Section XIV: Wholesale and Limited Purpose Banks.

Section XIV describes the Agencies' proposed Community Development Financing Test for Wholesale and Limited Purpose Banks, which would include a qualitative review of a bank's community development lending and investments in each assessment area and an institution level-metric measuring a bank's volume of activities relative to its capacity. The Agencies also propose giving wholesale and limited purpose banks the option to have examiners consider community development service activities that would qualify under the Community Development Services Test.

Proposal Section XV: Strategic Plans.

The Agencies have proposed to retain the strategic plan option as an alternative method for evaluation under CRA. Banks that elect to be evaluated under a CRA strategic plan would continue to be required to request approval for the plan from the appropriate Federal banking agency. A bank's election for the strategic plan option would not affect its obligation, if any, to report data.

The Agencies also propose to introduce more specific criteria to ensure that all banks are meeting their CRA obligation to serve low- and moderate-income individuals and communities. The approach is intended to ensure that banks have a strong justification for why a strategic plan is necessary for their business model and strategy, and that banks evaluated under a strategic plan incorporate how the bank's retail lending and other activities help to meet the credit needs of low- and moderate-income individuals and communities whenever possible.

Banks approved to be evaluated under a CRA strategic plan option would have the same assessment area requirements as other banks and would submit plans that include the same performance tests and standards that would otherwise apply unless the bank is substantially engaged in activities outside the scope of the tests. In seeking approval for a plan that does not adhere to requirements and standards that are applied to other banks, the plan would be required to include an explanation of why the bank's view is that different standards would be more appropriate in meeting the credit needs of its communities.

Proposal Section XVI: Assigned Conclusions and Ratings.

This section outlines how the Agencies propose conclusions and ratings, are assigned at the state, multistate MSA, and institution levels using a consistent, quantifiable approach. The proposed approach is intended to increase transparency and provide clarity on the assessment of a bank's overall CRA performance.

As an initial matter, the proposal would distinguish between conclusions—which generally refers to the bank's performance on a particular test at the assessment area, state, multistate MSA, or institution level—and ratings—which refers to a bank's overall CRA performance across tests at the state, multistate MSA, and institution levels.

With respect to conclusions, the Agencies propose maintaining five categories of performance test conclusions, as described in the Proposal, that splits the category of "Satisfactory" into "High Satisfactory" and "Low Satisfactory" to better differentiate between very good performance and performance on the lower end of the satisfactory range for each test-specific conclusion. With respect to ratings, the Agencies would continue to use the four categories— Outstanding, Satisfactory, Needs to Improve, and Substantial Noncompliance, as prescribed in the CRA statute.

The proposed ratings approach would combine a bank's conclusions, as described in proposed appendix C, for each applicable test according to a specified set of weights tailored to large banks, intermediate banks, and wholesale and limited purpose banks. The Proposal would apply the weighting approach for ratings at the state, multistate MSA, and institution level as described in proposed appendix D. In addition, the Agencies have proposed additional provisions intended to emphasize a bank's retail lending performance and the importance of assessing how a bank meets the credit needs of all the communities it serves without overlooking smaller or less populated assessment areas as specified in proposed appendix D.

For small banks evaluated under the small bank performance standards, the Agencies would assign lending evaluation conclusions of Outstanding, Satisfactory, Needs to Improve, or Substantial Noncompliance based on the bank's lending performance in each facility-based assessment area to arrive at the bank's overall rating assigned by the Agencies as explained in Section XVII of the Proposal.

The Agencies also propose updating the criteria on discriminatory and certain other illegal practices that could adversely affect a bank's CRA rating, as well as what rating level (state, multistate MSA, and institution) would be affected. Further, the Agencies propose adding additional laws and regulations to the illustrative list of examples of practices that could impact a bank's CRA rating.

Proposal Section XVII: Performance Standards for Small and Intermediate Banks.

This section describes that the Agencies have proposed to continue evaluating small banks under the small bank performance standards in the current CRA framework and to apply the proposed metrics-based Retail Lending Test to intermediate banks which will have certain provisions tailored to intermediate banks.

Under the Proposal, small banks could opt into the Retail Lending Test and could continue to request additional consideration for other qualifying CRA activities. For intermediate banks, in addition to the proposed Retail Lending Test, the Agencies have proposed to also evaluate an intermediate bank's community development activity pursuant to the criteria under the current intermediate small bank community development test. Intermediate banks could also opt to be evaluated under the proposed Community Development Financing Test.

Proposal Section XVIII: Effect of CRA Performance on Applications.

In Section XVIII, the Agencies have proposed to maintain the current regulatory provisions for considering CRA performance on bank applications, such as those for mergers and acquisitions, deposit insurance, and branch openings and relocations.

Proposal Section XIX: Data Collection, Reporting, and Disclosure.

Section XIX sets forth that the Agencies propose to revise data collection and reporting requirements to increase the clarity, consistency, and transparency of the evaluation process through the use of standard metrics and benchmarks. The Proposal recognizes the importance of using existing data sources where possible, and tailoring data requirements, where appropriate.

All large banks would have the same requirements for certain categories of data, including community development financing data, branch location data, and remote service facility location data. Some new data requirements would only apply to large banks with assets of over $10 billion. Large banks with assets of over $10 billion would have data requirements for deposits data, automobile lending data, retail services data on digital delivery systems, retail services data on responsive deposit products, and community development services data. The Proposal also provides updated standards for all large banks to report the delineation of their assessment areas. Data requirements for intermediate banks and small banks would remain the same as the current requirements.

Under the Proposal, the data reporting deadline would be moved from March 1 to April 1 of each year.

Proposal Section XX: Content and Availability of Public File, Public Notice by Banks, Publication of Planned Examination Schedule, and Public Engagement.

In Section XX the Agencies describe a desire to provide more transparent information to the public on CRA examinations and encourage communication between members of the public and banks. The Agencies have proposed to make a bank's CRA public file more accessible by allowing any bank with a public website to include its CRA public file on its website. The Agencies have also proposed publishing a list of banks scheduled for CRA examinations for the next two quarters at least 60 days in advance in order to provide additional notice to the public. Finally, the Agencies have proposed to establish a way for the public to provide feedback on community needs and opportunities in specific geographies.

Proposal Section XXI: Transition.

Section XXI sets forth the proposed timeline for the transition from the current regulatory and supervisory framework to a new CRA regulatory and supervisory framework. The Proposal would establish an effective date for the final rule the first day of the first calendar quarter that begins at least 60 days after publication in the Federal Register. The Agencies propose applicability dates for various provisions of the regulations which are applicable on, or over a period of time after, the effective date of the final rule.

The Agencies believe varying applicability dates would provide banks with time to transition from the current regulations to a new regulation for: collecting, maintaining, and reporting data; transitioning systems; and establishing policies and procedures necessary for the orderly implementation of the proposed regulatory framework.

The Agencies intend that, during the period between the final rule's effective date and the applicability dates in the final rule for certain provisions (transition period), the Agencies' current CRA regulations will remain in effect for the provisions. The Agencies would retain the authority to ensure an orderly transition between the two CRA frameworks and expect to issue guidance regarding the applicability of the relevant CRA framework during this time.

The Agencies also stated an intention to include their current CRA regulations in agency-specific appendices of a final rule and to sunset the appendices as of the final applicability date, at which point all banks would need to be in compliance with all provisions of the final rule.

Conclusion

The federal prudential banking Agencies have jointly issued a proposed rule to revise existing CRA regulations to better address how CRA activities qualify for consideration, where CRA activities are considered, and how CRA activities are evaluated. The joint proposal comes after much advocacy by Wisconsin bankers and the WBA for a uniform rule.

This article was meant to provide a high-level look at how the Agencies have proposed their respective CRA regulations be revised; the full proposal may be viewed from the link below. If you have questions regarding the proposal, be sure to contact WBA Legal at wbalegal@wisbank.com or at 608-441-1200.

The jointly-issued CRA proposal: https://www.govinfo.gov/content/pkg/FR-2022-06-03/pdf/2022-10111.pdf

Reporting HMDA Total Units and Cross-Collateralization

WBA has recently become aware of banks facing scrutiny over Home Mortgage Disclosure Act (HMDA) reporting. Specifically, reporting of the number of individual dwelling units when the covered loan is cross-collateralized by multiple properties. While the rules have not changed, there has been some confusion regarding the interplay of cross-collateralization clauses and HMDA rules. This article will discuss those HMDA requirements in relation to cross-collateralization considerations.

Subject to certain exemptions, HMDA requires financial institutions to report data on covered transactions. Data is reported on those fields as required by Regulation C section 1003.4. For institutions which qualify for a partial exemption, some of those fields are optional. For purposes of this article, only one of those data fields is discussed, being the number of individual dwelling units related to the property securing the covered loan or, in the case of an application, proposed to secure the covered loan (total units). This data point is required by Regulation C section 1003.4(a)(31). Total units is not a field subject to optional reporting.

The total units field requires a reporting institution to enter, in numeral form, the number of individual dwelling units related to the property securing the covered loan. For example, if there are five (5) individual dwelling units, bank will enter 5 on the HMDA LAR. When a loan is secured by multiple properties, bank may need to consider each of those properties securing the loan to properly report this field. This includes property securing the loan by any means.

This could be the result of future advance language or other cross-collateralization. For example, when taking a loan using the WBA 451 Business Note, cross-collateralization language is included which provides broad coverage in support of the bank as lender. This language provides in part that the note is secured by all existing and future security agreements and mortgages by the borrower, by any indorser or guarantor, and by any other person providing collateral security. Lenders must carefully consider this language, and its relationship with the borrower, including guarantors and other parties, in order to determine those properties which secure the loan. This type of broad cross-collateralization language is most common on business notes.

As a consumer example, when taking a loan secured by a WBA 428 Real Estate Mortgage, the mortgage document states that the mortgage will secure certain future advances. However, in general, most WBA consumer notes disclaim dwellings as collateral, unless the dwelling is specifically described in the note or agreement. So, a pre-existing mortgage on a dwelling does not secure a future consumer note or agreement unless the note or agreement specifically identifies the dwelling.[1]

1 This is for purposes of flood rules. For further discussion on cross-collateralization as it relates to flood requirements, please review the WBA Compliance Journal from February, 2022.

dar quarter that begins at least 60 days after publication in the Federal Register. The Agencies propose applicability dates for various provisions of the regulations which are applicable on, or over a period of time after, the effective date of the final rule.

The Agencies believe varying applicability dates would provide banks with time to transition from the current regulations to a new regulation for: collecting, maintaining, and reporting data; transitioning systems; and establishing policies and procedures necessary for the orderly implementation of the proposed regulatory framework.

The Agencies intend that, during the period between the final rule's effective date and the applicability dates in the final rule for certain provisions (transition period), the Agencies' current CRA regulations will remain in effect for the provisions. The Agencies would retain the authority to ensure an orderly transition between the two CRA frameworks and expect to issue guidance regarding the applicability of the relevant CRA framework during this time.

The Agencies also stated an intention to include their current CRA regulations in agency-specific appendices of a final rule and to sunset the appendices as of the final applicability date, at which point all banks would need to be in compliance with all provisions of the final rule.

Conclusion

The federal prudential banking Agencies have jointly issued a proposed rule to revise existing CRA regulations to better address how CRA activities qualify for consideration, where CRA activities are considered, and how CRA activities are evaluated. The joint proposal comes after much advocacy by Wisconsin bankers and the WBA for a uniform rule.

This article was meant to provide a high-level look at how the Agencies have proposed their respective CRA regulations be revised; the full proposal may be viewed from the link below. If you have questions regarding the proposal, be sure to contact WBA Legal at wbalegal@wisbank.com or at 608-441-1200.

The jointly-issued CRA proposal: https://www.govinfo.gov/content/pkg/FR-2022-06-03/pdf/2022-10111.pdf

Reporting HMDA Total Units and Cross-Collateralization

WBA has recently become aware of banks facing scrutiny over Home Mortgage Disclosure Act (HMDA) reporting. Specifically, reporting of the number of individual dwelling units when the covered loan is cross-collateralized by multiple properties. While the rules have not changed, there has been some confusion regarding the interplay of cross-collateralization clauses and HMDA rules. This article will discuss those HMDA requirements in relation to cross-collateralization considerations.

Subject to certain exemptions, HMDA requires financial institutions to report data on covered transactions. Data is reported on those fields as required by Regulation C section 1003.4. For institutions which qualify for a partial exemption, some of those fields are optional. For purposes of this article, only one of those data fields is discussed, being the number of individual dwelling units related to the property securing the covered loan or, in the case of an application, proposed to secure the covered loan (total units). This data point is required by Regulation C section 1003.4(a)(31). Total units is not a field subject to optional reporting.

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This could be the result of future advance language or other cross-collateralization. For example, when taking a loan using the WBA 451 Business Note, cross-collateralization language is included which provides broad coverage in support of the bank as lender. This language provides in part that the note is secured by all existing and future security agreements and mortgages by the borrower, by any indorser or guarantor, and by any other person providing collateral security. Lenders must carefully consider this language, and its relationship with the borrower, including guarantors and other parties, in order to determine those properties which secure the loan. This type of broad cross-collateralization language is most common on business notes.

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Lenders need to review their notes and security agreements for this, and similar language. While this is important for a number of reasons, this article strictly discusses the significance of such language as it relates to reporting HMDA total units.

When reporting total units, HMDA provides clarity within its commentary. Comment 1 to section 1003.4(a)(31) makes a cross-reference to section 1003.4(a)(9) comment 2 regarding transactions involving multiple properties with more than one property taken as security (comment 2). This discussion provides clarity regarding how to report on various data points. Comment 2 draws distinctions between those data points which require reporting for a single property (selected by the lender), and those which must be considered for every property securing the loan (in addition to that single property selected by the lender). The information reported for total units is one of those which must be reported for every property securing the loan. Comment 2 in relevant part provides:

> "…for aspects of the entries that do not refer to the property identified in §1003.4(a)(9) (i.e., §1003.4(a)(1) through (4), (7), (8), (10) through (13), (15) through (28), (31) through (38)), Financial Institution A reports the information applicable to the covered loan or application and not information that relates only to the property identified in §1003.4(a)(9)."

Because the commentary includes total units as one of those categories for which information must be reported applicable to the covered loan, and not that which relates only to the single property identified under 1003.4(a)(9), then the lender must report total units based upon every property which secures the loan. As a result, lenders must consider whether the loan is secured by multiple properties. Lenders must review their language specifically to make this determination, but as a final point of distinction, note that the effect of cross-collateralization clauses is to secure the loan with multiple properties.

While this is not a new rule, it is recommended that banks review the above HMDA sections as a refresher. From there, banks should review their contracts and HMDA reporting to ensure that all applicable fields are being reported for all applicable properties. It may be that additional monitoring systems need to be put into place to account for multiple properties securing a loan. Banks should conduct this review in advance of any upcoming compliance exam and prepare accordingly.

In summary, if a loan is secured by multiple properties, those properties must be included for purposes of reporting total units. As a result, lenders must review their notes and security agreements to understand the extent of how their loans are secured. This is a contractual matter which can vary from note to note, and from one loan relationship to the next. As such, each loan relationship must be reviewed to determine HMDA reporting requirements. Lastly, as mentioned above, this article is specific to the implications of cross-collateralization clauses in relation to reporting of total units for HMDA purposes. However, cross-collateralization clauses are important to understand for reasons beyond HMDA reporting, and such matters will be addressed in a broader sense in a future article.

For any questions on this matter or others, please contact WBA's legal team at wbalegal@wisbank.com or 608-441-1200.

New CFPB Advisory Opinion Fails to Consider Wisconsin's Marital Property Act

A frequently asked question to the WBA Call Program has long been, "May a bank pull a credit report on a non-applicant spouse when a married Wisconsin resident applies for credit individually?" WBA's longstanding answer has been – Yes. Banks have a permissible purpose under the Fair Credit Reporting Act (FCRA) to pull credit on the non-applicant spouse when an applicant is a married Wisconsin resident. Under Wisconsin's Marital Property Act (MPA), the creditor need consider the couple a unit, taking into consideration all income and all debt of both spouses.

The Bureau of Consumer Financial Protection (CFPB) recently issued an advisory opinion regarding permissible uses of credit reports. The opinion appears to be primarily directed at consumer reporting agencies who furnish credit reports. However, given statements within the opinion regarding use of credit reports, WBA believes it worth a reminder about how the MPA plays a role in there being a legitimate business need for a bank to pull a credit report on a non-applicant spouse when a married Wisconsin resident applies for credit individually as CFPB failed to take into considerations a State's property laws when it analyzed permissible purposes under FCRA Section 604.

Under the MPA, when credit will result in an obligation that is "in the interest of marriage or the family" pursuant to s. 766.56(1), Stats., creditors need consider both the assets and liabilities of each spouse when evaluating an applicant spouse's creditworthiness. By reviewing both the assets and liabilities of each spouse, the creditor can meet its obligations under s. 766.56(1) to consider "all marital property available to satisfy the obligation in the same manner that the creditor, in evaluating the creditworthiness of an unmarried credit applicant, considers the property of an unmarried credit applicant…" Credit reports are the tools most often used to determine liabilities of both spouses.

The Federal Trade Commission (FTC), the agency with authority for banks regarding FCRA prior to the Dodd-Frank Act, recognized states' property laws under its interpretation of FCRA permissible purposes. To use a credit report, the FCRA provides that one must have a permissible purpose for the report. FCRA Section 604 sets forth the permissible purposes of credit reports. Section 604(a)(3)(A) allows a consumer reporting agency to furnish consumer reports to a person which it has a reason to believe "intends to use the

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Under the MPA, when credit will result in an obligation that is "in the interest of marriage or the family" pursuant to s. 766.56(1), Stats., creditors need consider both the assets and liabilities of each spouse when evaluating an applicant spouse's creditworthiness. By reviewing both the assets and liabilities of each spouse, the creditor can meet its obligations under s. 766.56(1) to consider "all marital property available to satisfy the obligation in the same manner that the creditor, in evaluating the creditworthiness of an unmarried credit applicant, considers the property of an unmarried credit applicant…" Credit reports are the tools most often used to determine liabilities of both spouses.

The Federal Trade Commission (FTC), the agency with authority for banks regarding FCRA prior to the Dodd-Frank Act, recognized states' property laws under its interpretation of FCRA permissible purposes. To use a credit report, the FCRA provides that one must have a permissible purpose for the report. FCRA Section 604 sets forth the permissible purposes of credit reports. Section 604(a)(3)(A) allows a consumer reporting agency to furnish consumer reports to a person which it has a reason to believe "intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer". Past FTC interpretation of this section has confirmed that creditors may pull a credit report on a non-applicant spouse.

In particular, FTC interpretation of FCRA Section 604(a)(3)(A) has been,

> "A creditor has a permissible purpose to obtain a consumer report on an applicant's spouse if that spouse will be permitted to use the account or will be contractually liable upon the account, or if the applicant is relying on the spouse's income as a basis for repayment of the credit requested. In addition, a creditor may obtain a consumer report on an applicant's spouse if (i) the state law doctrine of necessaires (which may make a consumer liable for certain debts of a spouse) applies to the transaction, (ii) the applicant resides in a community property state, (iii) the property upon which the applicant is relying as a basis for repayment of the credit requested is located in such a state, or (iv) the applicant is acting as the agent of the nonapplicant spouse."

The requirements under the MPA and FTC's interpretation of a permissible purpose under the FCRA were the areas of law WBA has cited as rationale why banks may use the consumer reports of both the married Wisconsin resident applicant and his/her non-applicant spouse when determined debt in connection with new credit or review of an account.

However, with CFPB having issued an advisory opinion regarding the furnishing and use of credit reports under the FCRA, members need be aware of the opinion.

In its opinion, CFPB stated that the permissible purposes listed in FCRA section 604(a)(3) are consumer specific and that a consumer reporting agency may not provide a consumer report to a user under FCRA section 604(a)(3) unless it has reason to believe that all of the consumer report information included pertains to the consumer who is the subject of the user's request. CFPB believes section 604 analysis need be on a consumer-by-consumer basis, intending the use of information in connection with a credit transaction to be one involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer.

CFPB's new advisory opinion could be read to not allow a credit report to be pulled on a non-applicant spouse as the non-applicant spouse is not party to the application. In writing the opinion, CFPB has failed to consider a state's property law—such as the Wisconsin MPA—and of the legitimate business need for debt information. Separately, a creditor cannot require spouses to apply together to then obtain a credit report on both spouse as that would be a violation of Regulation B. CFPB's focus only on federal law when writing this opinion without considering state marital property laws raises a question for banks in marital/community property states, including Wisconsin banks when trying to comply with s. 766.56(1) Stats.

WBA believes banks do have a permissible purpose under state law, and therefore under FCRA section 604, to obtain a credit report of a non-applicant spouse in connection with an application involving a married Wisconsin resident, since CFPB's advisory opinion focuses solely on the fact that FCRA permissible purposes are consumer-specific and is silent on any relevant state law.

It is clear under s. 766.56(1), Stats., that when credit will result in an obligation that is "in the interest of marriage or the family", creditors need consider both the assets and liabilities of each spouse when evaluating an applicant spouse's creditworthiness. This requirement results in a legitimate business need to identify debts of both the applicant spouse and non-applicant spouse. Furthermore, pursuant to s. 766.55(1), Stats., an obligation incurred while married is presumed to be incurred in the interest of the marriage or family, and under para. (2) the obligation is to be satisfied from all marital property and all other property of the married Wisconsin resident applicant. These MPA provisions make the non-applicant spouse part of the credit transaction and resulting obligation for which a credit report is being used thereby meeting the conditions under CFPB's advisory opinion despite CFPB not specifically addressing marital property interests.

Due to the requirements of ss. 766.55 and 766.56, Stats., banks have a permissible purpose under FCRA section 604(a)(3) to use a consumer report of a non-applicant spouse when an applicant is a married Wisconsin resident. A bank's current practice to pull a credit report on both spouses need not change as a result of CFPB's advisory opinion.

While CFPB's release is only that of an advisory opinion, and is not regulation, WBA wanted to make sure that members are aware of the opinion and its narrowness, along with WBA's thoughts on it. CFPB's FCRA Advisory Opinion may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_fair-credit-reporting_advisory-opinion_2022-07.pdf

Wisconsin Bankers Association

June 2022

Compliance Journal

Special Focus

Summary of Recently Enacted State Legislation

The 2021-2022 Wisconsin legislative session concluded earlier this year. WBA's state legislative lobbying efforts took on a largely defensive posture this session, which succeeded in repelling every threat faced by the banking industry. Through a combination of grassroots efforts conducted by many Wisconsin banks, the advocacy of many individual bankers, and WBA's government relations team, the industry managed to defeat a bill that would have expanded credit union powers, legislation disrupting electronic payments, and several proposals seeking to take bank decision-making away from the industry. There was even more activity this session, and this article is designed as a recap to the most significant aspects.

Traditionally, WBA legislative recap articles have focused only on bills which have been signed into law. However, due to the level of significance of the issues faced by the industry during this previous session, this article will discuss legislative activity beyond that scope. As such, this article will discuss not only legislation which was signed into law, but also key pieces of legislation which were defeated, and bills which WBA supported as top priorities for the industry but were unfortunately not passed this session. As a result, this article is organized into sections based upon pieces of legislation which were signed into law, and those which were not.

Legislation Signed into Law this Session

Study and Report on Establishing ABLE Accounts

Under federal law, states may create a qualified Achieving a Better Life Experience (ABLE) program. Accounts created under such a program are for the benefit of an individual with disabilities. They are generally created as tax-exempt savings accounts to pay for qualified expenses, such as education, housing, and transportation costs. Under current law, Wisconsin has adopted a provision of federal law which allows ABLE accounts to be established in any state, not just in the state of residence of the disabled individual. As a result, individuals with disabilities may establish an ABLE account in another state as Wisconsin does not have an ABLE program.

In February, 2021 Wisconsin Act 119 was signed into law which requires the Wisconsin Department of Financial Institutions (DFI) to conduct a study to examine the advantages and disadvantages of establishing a Wisconsin ABLE program for state residents. WBA is aware that Wisconsin banks have customers who desire ABLE accounts. Depending upon the results of the study, options for customers may change in the future.

Revised Uniform Unclaimed Property Act

This session, Wisconsin adopted the Revised Uniform Unclaimed Property Act (RUUPA or Act). RUUPA was signed into law through 2021 Wisconsin Act 87 and replaces Wisconsin's previous unclaimed property law. While there are some similarities to the previous law, banks should familiarize themselves with the new Act and review their procedures accordingly. This article is designed to provide the legislative significance of the Act and is not intended to serve as a summary of the new law. However, WBA is in the process of creating further resources to assist Wisconsin banks which will be available in the future.

RUUPA requires a holder of unclaimed property to submit that property to the state after a certain time has passed, a period referred to as a dormancy period. The state then attempts to return the property to its rightful owner. Generally, if the state is unable to return the property to its owner, the state may retain the property. RUUPA designates the Department of Revenue as the administrator of the Act and makes various changes in order to make the Act easier to administer. For example, RUUPA updates the law to address the disposition of unclaimed gift cards, life insurance benefits, securities, and virtual currencies. The bill also organizes chapter 177 into subchapters in order to facilitate the Act's administration.

Business Law Rewrite

Wisconsin passed a series of uniform laws related to the formation of business entities in Wisconsin. 2021 Wisconsin Act 258 (Act 258) repeals and replaces existing laws related to partnerships and limited liability companies (LLC) with modified versions of their uniform counterparts. Act 258 also makes changes to the law governing business corporations and nonstock corporations that generally correspond to the changes applicable to limited partnerships, LLCs, and partnerships.

This session's business law rewrite does not directly impact banks, but still requires consideration of bank's policies and procedures in relation to their commercial customer lines of business. Act 258 is significant, coming in at nearly 500 pages. WBA is in the process of developing resources to assist banks in understanding the potential impact of the changes.

PACE Program Changes

A final bill signed into law this session worth mentioning, makes various changes to the property assessed clean energy (PACE) program. The bill was ultimately signed into law after inclusion of a WBA-led amendment. The bill was signed into law as 2021 Wisconsin Act 175.

PACE is a program which allows property owners to obtain low-cost, long-term loans for energy efficiency, renewable energy, and water conservation improvements. Through PACE, Wisconsin municipalities and counties work with private sector lenders to provide financing for improvements to qualified projects. The program outlines which properties and improvements are eligible, project requirements, financing, approval, and installation of the project. The bill broadens the applicability of the program, financing options, and, among other things, would have changed the timing of the attachment of a lien under the program.

Currently, when a PACE loan becomes delinquent, the program creates a superior lien to bank's own interest in the property, in favor of the local government entity sponsoring the improvement. The bill would have changed the timing so that the interest became effective as of the date of the loan, rather than at time of delinquency. However, a WBA-led amendment deleted the change which would have changed the timing of when a lien attaches to the property benefitting from the PACE program. As a result of the amendment, a lien attaches to such property when an installment payment is delinquent, just as it did under previous law.

There are two new provisions lenders need be aware of when working with properties involving a PACE program. If a delinquent installment payment becomes a lien on the property, the lien now runs with the land. Also, there is a new notice requirement. A political subdivision that makes a PACE loan must now require that the owner or lessee obtain the written consent of all holders of a mortgage of record on the premises as a condition of making a PACE loan or entering into a PACE agreement.

While PACE programs can be helpful, lenders need be mindful of the impact the super priority status PACE program liens have on the bank's own security interest in the property and of the fact a PACE program lien runs with the land.

Bills Not Signed into Law this Session

Credit Unions

This legislative session saw a bill presented which would have significantly expanded the authority of credit unions to engage in activities outside the scope of their charters and originally intended purpose. There were several items within the bill, many of which WBA did not oppose. However, there were four seriously objectionable sections of the legislation as drafted which, if enacted, would inappropriately expand credit union powers, and further erode the distinction between credit unions and commercial banks.

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The industry had four primary objections, addressed to the following expansions of power within the bill:

- Allowing of non-member participation in loans or extension of credit,
- Allowing of credit unions to issue or offer supplemental forms of capital,
- Allowing of automatic adoption of federally-chartered credit union activities or powers for state-chartered credit unions with only weak government oversight, and
- Broadening of credit unions' ability to purchase, hold, or dispose of property.

During the 2021-2022 session WBA staff and contract lobbyists met numerous times with bill authors and committee chairs regarding objections to these four provisions. WBA, and members, also gathered for two public hearings to testify and voice the industry's opposition. Additionally, the industry collaborated through extensive grassroots communication between banks and legislators. Advocacy efforts included a letter of opposition signed by 90 community banks. Ultimately, these efforts prevented the bill from receiving floor votes in both houses, successfully stopping its passage into law.

While the Wisconsin Legislature's 2021-22 regular session has concluded, and the bill was defeated, on February 15, the Wisconsin Office of Credit Unions (OCU) filed a final rule to broaden which state-chartered credit unions can accept secondary capital. WBA created a template letter for members to present concerns with the expansion and filed its own letter as well with OCU requesting specific limitations.

Previous rules allowed only low-income designated state-chartered credit unions the authority to accept secondary capital. The revised rule broadens the authority to allow nearly any credit union to issue subordinated debt, for among other things, pure asset growth purposes. As a result, WBA's efforts to address the concerns presented by the expansion of credit union powers continues.

Interchange/Credit Card Swipe Fees

Another issue facing the industry this session was an initiative to prohibit charging merchants credit card swipe fees for the tax portion of a credit card transaction. This effort in Wisconsin followed similar proposals which had been made in other states over the last 15 years, but the policy has yet to be enacted elsewhere. Given existing technologies, it would be impossible for electronic payment networks to implement the necessary systems to comply with the prohibitions presented by the bill. WBA opposed the bill, on the grounds that such issues are a matter of contract, for businesses to agree to. The bill, however, was an attempt to use government to intervene in business, to shift costs from retailers to the financial institutions industry.

This was a significant issue this session as credit card acceptance guarantees payment in a speedy fashion for retailers, while protecting important personal information. As card issuers, Wisconsin banks bear the burden of data privacy, fraud prevention, card maintenance, and other aspects of business. Fees associated with those realities are a cost of doing business, arranged for by contract. It is not appropriate for the government to mandate certain fee restrictions. The bill received a hearing in one house before it was dropped, and successfully defeated.

Banking Modernization Omnibus Bill

This session's banking modernization bill is similar to those spearheaded by WBA in previous sessions, being a piece of legislation presenting numerous positive changes for the banking industry. More specifically, the bill would have done the following:

- Provide a statutory right to offset funds held in a payable-on-death account for loans made to the account owner.
- Increase the amount available through the public deposit guaranty fund to state and local government depositors from $400,000 to $1,000,000.
- Repeal outdated DFI rules related to notices for the placement and operation of automated teller machines.
- Prohibit requiring financial institutions to install an access box to any financial institution building (also known as a "knox box").
- Extend the maximum maturity date from 10 to 20 years for promissory notes issued by a city, village, town, county, or school district.

While the bill passed unanimously on a voice vote in the Senate, it was unfortunately not taken up by the full Assembly and did not pass this session. This was disappointing, but these issues, among others, remain priorities for WBA and will be considered again in an upcoming session.

Special Focus

Elder Financial Exploitation Prevention

A long-standing issue for the industry has been elder financial abuse, and a top priority for WBA has been pursuing the creation of tools to help Wisconsin banks combat it. Legislation was introduced this session which would have provided those tools. The bill would have allowed financial service providers to refuse or delay financial transactions when financial exploitation of a vulnerable adult was suspected. It would have permitted certain additional actions, such as refusal to accept a power of attorney's authority where abuse is suspected and maintaining a list of authorized contacts whom a financial institution could contact when abuse is suspected.

WBA and its membership provided testimony to the Committee on Criminal Justice and Public Safety, reached out to lawmakers directly to provide examples of situations where the provisions in the bill could have been used to stop elder financial abuse, and through these efforts the bill passed the State Assembly on a voice vote, but ultimately died in the Senate Committee on Financial Institutions and Revenue.

WBA is aware that elder abuse continues to be prevalent among customers of Wisconsin banks. It will remain a top priority, and WBA will continue to pursue legal tools and protections so that banks standing on the frontlines of this issue can be best equipped to stop bad actors and protect their customers. Currently, the only resources available to banks are on the county level with elder abuse reporting agencies and the Wisconsin Department of Justice (DOJ). The DOJ maintains a hotline for reporting elder abuse at 1-800-488-3780. WBA encourages banks to consider utilizing a memorandum of understanding with its local elder abuse reporting agency, and use of the DOJ hotline.

Data Privacy

This session saw introduction of a bill creating new consumer rights regarding personal data held by controllers of that data. The bill would have placed certain restrictions and requirements upon controllers of personal data, subject to certain exceptions. WBA was able to obtain an exception added for financial institutions and their affiliates subject to Gramm-Leach-Bliley Act requirements, effectively excluding Wisconsin banks and their affiliates from coverage of the bill. Furthermore, the bill did not pass the Senate and was not enacted this session.

Conclusion

WBA will continue to monitor and advocate on issues, including those discussed above and others, which impact the Wisconsin banking industry. While this session involved more of a defensive posture, many priorities remain which WBA will work toward. If you have any additional questions on any of the above bills or issues, do not hesitate to contact us at: wbalegal@wisbank.com. ■

Regulatory Spotlight

Agencies Issue Revised Interagency Questions and Answers Regarding Flood Insurance.

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 National Credit Union Administration (NCUA) (collectively, the agencies) have reorganized, revised, and expanded the Interagency Questions and Answers Regarding Flood Insurance. The revised guidance will assist lenders in meeting responsibilities under federal flood insurance law and increase public understanding of the agencies' respective flood insurance regulations. Significant topics addressed by the revisions include guidance related to major amendments to the flood insurance laws with regard to the escrow of flood insurance premiums, the detached structure exemption, force placement procedures, and the acceptance of flood insurance policies issued by private insurers. With the issuance, the agencies have consolidated the Questions and Answers proposed in July 2020 and the Questions and Answers proposed in March 2021 into one set of Interagency Questions and Answers Regarding Flood Insurance. The issuance date of the guidance is **05/11/2022**. The guidance may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-05-31/pdf/2022-10414.pdf. *Federal Register*, Vol. 87, No. 104, 05/31/2022, 32826-32895.

Wisconsin Bankers ASSOCIATION

May 2022

Compliance Journal

Special Focus

Revisiting CFPB's General QM Final Rule

Introduction

With the mandatory compliance date of the new General Qualified Mortgage rule fast approaching, WBA has written this article to help refresh bankers' understanding of the rule's requirements and ensure adequate preparation for mortgage lending operations. The final rule's mandatory compliance date is **October 1, 2022**.

Background

In the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress adopted ability-to-repay (ATR) requirements for virtually all closed-end residential mortgage loans. Congress also established a presumption of compliance with the ATR requirements for certain categories of mortgages, called qualified mortgages (QMs). The Bureau of Consumer Financial Protection (CFPB) subsequently wrote rules to implement these requirements (ATR/QM Rule).

With certain exceptions, the ATR/QM Rule requires creditors to make a reasonable, good faith determination of a consumer's ability to repay a residential mortgage loan and provides certain protections from liability for residential mortgage loans that meet the ATR/QM Rule's requirements for QMs. The ATR/QM Rule also establishes different categories of QMs.

One QM category is the General QM category. For a residential mortgage loan to fit within the General QM category, the ratio of the consumer's total monthly debt to total monthly income (DTI) must not exceed 43 percent, and the creditor 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.

In December 2020, CFPB issued a final rule (Final Rule) to replace the existing 43 percent debt-to-income ratio limit (including removal of Appendix Q) in the General QM definition with price-based thresholds along with other changes to the ATR/QM Rule. WBA previously published a toolkit to assist Wisconsin banks in understanding these revisions and develop an implementation plan, including template policies. This article is not designed to repeat that information, but rather serve as a refresher on some of the broader points of the rule, as well as present implementation timeline considerations, to prepare for the upcoming mandatory compliance date of **October 1, 2022**.

Revised General QM Definition

As discussed above, the Final Rule amends Regulation Z to replace the existing General QM definition. The Final Rule replaces the existing 43 percent DTI limit with a price-based limit and removes Appendix Q, including any requirements to use Appendix Q for General QM loans. However, it still retains consider and verify requirements. As a result, it amends those requirements accordingly, along with associated commentary.

The summary below is intended to provide a refresher to some of the broader concepts presented by the Final Rule. WBA recommends referring to the full rule itself, including its commentary, for further understanding. A link to the Final Rule, the current rule, as well as WBA's toolkit, is provided at the end of this article as additional resources.

Price-Based Limit

A loan meets the revised General QM definition only if the annual percentage rate (APR) does not exceed the average prime offer rate (APOR) for a comparable transaction in accordance with the applicable threshold as of the date the interest rate is set. The Final Rule sets new limits for determining whether an APR exceeds the APOR. Generally, this threshold is 2.25 percentage points. However, the General QM Final Rule provides higher thresholds for loans with smaller loan amounts, for certain manufactured housing loans, and for subordinate-lien transactions. Generally, a transaction's APR is compared to the APOR as of the date the transaction's interest rate is set (or "locked") before consummation.

Additionally, 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 discussed above.

Additional information on determining the APR, the APOR, and the applicable threshold is available in the Final Rule.

Consider and Verify Requirements

The Final Rule retains consider and verify requirements. It requires creditors to consider the consumer's current or reasonably expected income or assets (other than the value of the dwelling that secures the loan and any real property attached to that dwelling), debt obligations, alimony, child support, and DTI ratio or residual income. Creditors must also verify this information by using reasonably reliable third-party records and reasonable methods and criteria.

However, the Final Rule does not prescribe specifically how a creditor must consider the monthly DTI ratio or residual income, identify a particular monthly DTI ratio or residual income threshold, or specify methods of underwriting that a creditor must use (other than to require that verification methods and criteria must be reasonable). Furthermore, the Final Rule provides flexibility for a creditor to take into account additional factors that are relevant in determining a consumer's ability to repay the loan.

While the Final Rule has removed Appendix Q, the Final Rule does provide clarifications to the consider and verify requirements under the revised General QM definition. For example, the Final Rule provides specific methods to meet those requirements such as consideration of certain income and/or assets, appropriate policies and procedures, and retention of documentation to show how the bank applied those policies and procedures. Also note that if a creditor does not satisfy this documentation requirement for a loan, that loan will not meet the revised General QM definition.

The Final Rule also includes a list of specific verification standards that creditors may use to receive a safe harbor for compliance. These standards include relevant provisions in certain loan program guides and handbooks. The Final Rule sets forth the specific provisions and versions of these manuals and permits usage of substantially similar revised versions. These standards, including links, are also included in the WBA toolkit.

Mandatory Compliance Date

On April 30, 2021, CFPB issued a final rule to postpone the mandatory compliance date of the Final Rule from July 1, 2021, until **October 1, 2022**. Creditors, however, have the option of early compliance. Meaning, for covered transactions for which creditors have received an application on or after March 1, 2021, but prior to October 1, 2022, creditors have the option of complying with either the original debt-to-income based General QM definition, or the revised, price-based General QM loan definition as outlined above. However, creditors seeking to use the General QM loan category on or after **October 1, 2022**, must utilize the price-based General QM loan definition.

Implementation Considerations

Given the mandatory compliance date of **October 1, 2022**, banks should confirm that their implementation steps are in place. Banks should prepare to fully transition current policies and procedures to conform with the new definition and consider what training might be necessary in advance of and after the transition.

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Banks have likely already taken time to evaluate the categories of QMs they originate, and how the revised General QM definition may or may not affect current loan policy and underwriting procedures. Even banks which originate Small Creditor QMs should still consider the extent to which they may or may not originate General QMs. For example, does bank originate General QMs? Will it continue to do so, or will it exclusively utilize the Small Creditor QM exception, if applicable?

After this evaluation, banks should ensure that they have developed an implementation plan and review this plan in preparation for the mandatory compliance date. This plan should include a determination as to the extent to which the rule affects the bank's mortgage lending operation (including identification of affected products), consideration of operational and technology changes, adjustments to loan policy, and training needs. The WBA General QM Loan Toolkit is designed to help banks develop an implementation policy, including more specific considerations, a template policy, and template Board approval. A link to the toolkit is included at the end of this article. The rest of this article will discuss some additional considerations to better prepare for the upcoming mandatory compliance date.

Banks that have not already developed an implementation plan should look to do so as soon as possible. An implementation plan will ensure a smoother, more consistent transition. Banks that have already developed an implementation plan should review the plan in order to prepare for October. This review should include confirming applicability and assess whether any adjustments are necessary (ex: has there been a change in General QM usage? Products?). Bank should then consider its implementation timeline. Even if the bank will not be utilizing the new definition early, it should consider what steps are necessary to prepare for the mandatory compliance date of **October 1, 2022**. Some considerations include:

- What advanced adjustments to policies and procedures are yet to be made?
- Is Board approval still necessary for any changes to underwriting policies? Other?
- Which staff need to be involved and updated on regarding the upcoming transition?
- Has any advanced training been planned? Subsequent training following the transition?
- What technology needs to be updated? What new technologies need to be put into place? Are there additional technology-specific training needs?
- What testing still needs to be conducted? By when?
- Based upon these changes, what risk assessment has been performed? Has bank's bonding and insurance coverage provider been updated of any relevant changes, if applicable?
- What other deadlines are approaching based upon bank's implementation plan?

Banks should be looking to these, among other considerations, to better prepare for the upcoming mandatory compliance date.

Conclusion

The Final Rule presents changes to the General QM definition which may create significant implications for a bank's mortgage lending operation. The goal of this article is to provide a reminder of that significance by highlighting some of the most prominent aspects of the rule and presenting implementation considerations so that banks can be as best prepared as possible for the **October 1, 2022** mandatory compliance date. Additional resources are provided below for further consideration.

Additional Resources

- WBA ATR/QM Toolkit (will download a .doc file): https://www.wisbank.com/media/569957/wba-reg-z-atr-revised-general-qm-definition-toolkit.docx
- December 29, 2020 Final Rule: https://www.govinfo.gov/content/pkg/FR-2020-12-29/pdf/2020-27567.pdf
- April 30, 2021 Final Rule (delay): https://www.govinfo.gov/content/pkg/FR-2021-04-30/pdf/2021-09028.pdf
- Ability-to-Repay and Qualified Mortgage Small Entity Compliance Guide: https://files.consumerfinance.gov/f/documents/cpfb_atr-qm_small-entity_compliance-guide.pdf
- Regulation Z and its Official Commentary: https://www.consumerfinance.gov/rules-policy/regulations/1026/1/ ■

Special Focus

Revised Interagency Flood Questions and Answers Released

Just as the May edition of the *WBA Compliance Journal* was put into production, 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 National Credit Union Administration (NCUA) released revised Interagency Questions and Answers Regarding Flood Insurance (Interagency Questions and Answers). The Interagency Questions and Answers address frequently asked questions about the flood insurance requirements of the National Flood Insurance Act as amended, and its accompanying regulation.

Significant topics addressed by the revisions include guidance related to major amendments to the flood insurance laws with regard to the escrow of flood insurance premiums, the detached structure exemption, force placement procedures, and the acceptance of flood insurance policies issued by private insurers. With the issuance, the agencies have consolidated the Questions and Answers proposed by the agencies in July 2020 and the Questions and Answers proposed by the agencies in March 2021 into one set of Interagency Questions and Answers Regarding Flood Insurance.

A more comprehensive article regarding the updated resource will be forthcoming in a later edition of the *WBA Compliance Journal*. The revised Interagency Questions and Answers may be viewed at: https://www.fdic.gov/news/financial-institution-letters/2022/fil22020a.pdf ■

Regulatory Spotlight

Agencies Propose Changes to Uniform Rules of Practice and Procedure.

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) issued a proposed rule to change the Uniform Rules of Practice and Procedure to recognize the use of electronic communications in all aspects of administrative hearings and to otherwise increase the efficiency and fairness of administrative adjudications. FRB, FDIC, and OCC have also proposed to modify agency-specific rules of administrative practice and procedure. Comments are due **06/13/2022**. The proposed rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-04-13/pdf/2022-04454.pdf. *Federal Register*, Vol. 87, No. 71, 04/13/2022, 22034-22092.

Agencies Issue Proposed Community Reinvestment Act 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 proposed rule to amend their regulations which implement the Community Reinvestment Act (CRA) to update how CRA activities qualify for consideration, where CRA activities are considered, and how CRA activities are evaluated. Comments are due **08/05/2022**. The proposed rule may be viewed at: https://www.fdic.gov/news/board-matters/2022/2022-05-05-notice-dis-a-fr.pdf.

CFPB Publishes Spring Supervisory Highlights in *Federal Register*.

The Bureau of Consumer Financial Protection (CFPB) issued its twenty-sixth edition of Supervisory Highlights. The findings included in the report cover examinations completed between July 2021 and December 2021 in the areas of auto servicing, consumer reporting, credit card account management, debt collection, deposits, mortgage origination, prepaid accounts, remittances, and student loan servicing. CFPB released the edition on its website **05/02/2022**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-05-05/pdf/2022-09690.pdf. *Federal Register*, Vol. 87, No. 87, 05/05/2022, 26727-26738.

CFPB Issues Procedural Rule on Supervisory Authority of Certain Nonbank Covered Persons Based on Risk Determination.

CFPB issued a procedural rule to amend an aspect of procedures for establishing supervisory authority based on a risk determination.

Wisconsin Bankers ASSOCIATION

April 2022

Compliance Journal

Special Focus

FDIC Identifies Charges in Connection with Deposit-Related Activities as Potential UDAAP

In two separate publications, the Federal Deposit Insurance Corporation (FDIC) recently identified deposit-related activities which, depending upon how a bank discloses charges for such activities, may result in a heightened risk of violations of Section 5 of the FTC Act, known as unfair, deceptive, or abusive acts or practices (UDAAP).

FDIC has identified the assessment of overdraft fees for “force pay” transactions and charging multiple NSF fees for same transactions presented multiple times against insufficient funds as the deposit-related activities of concern. Both scenarios are outlined below.

Potential Issues with Assessing Overdraft Fees for “Force Pay” Transactions

In a quarterly newsletter issued by its Dallas Region, FDIC outlined potential issues with assessing overdraft fees for “force pay” transactions in certain situations. There may be times when a bank authorizes an ATM or one-time POS debit card transaction based on sufficient funds in a consumer’s account at the time of authorization; however, at settlement, the account has insufficient funds to cover the transaction. Due to a bank’s contract with its payment network providers, the bank is required to pay these transactions even though the customer does not have sufficient funds in their account at settlement. FDIC refers to this type of transaction as a “force pay” transaction.

As outlined by FDIC, some banks have a policy and practice of declining to authorize and pay any ATM or one-time POS debit card transactions when a customer has insufficient funds available in the account to cover the transaction. FDIC refers to these banks as “no pay” banks. Other banks may offer an overdraft program, but some consumers do not qualify, have not yet met all eligibility requirements, or do not opt-in to participate.

FDIC has identified that some no pay banks solicit a consumer’s authorization or opt-in, using an overdraft opt-in form similar to the Regulation E model form A-9, to assess overdraft fees for ATM and one-time POS debit card transactions in force pay transactions.

FDIC stated it believes the use of the A-9 model form for this purpose may be considered deceptive, as a reasonable consumer may be misled into believing that the bank would generally pay all overdrafts caused by ATM and one-time POS debit card transactions. Additionally, the A-9 model form does not disclose that force pay transactions would be paid regardless of whether the consumer opts in.

FDIC also identified how force pay transactions could lead to concerns at banks that offer overdraft programs. In particular, FDIC took issue when banks assessed fees for force pay transactions, but the consumer did not have access to the bank’s overdraft coverage due to a qualification period before coverage began, and alternatively, when a consumer previously opted in for coverage of ATM and one-time POS debit card transactions however the overdraft privileges were terminated, or the consumer may have revoked his/her prior opt-in.

FDIC offered the following suggestions to mitigate risks:

- Maintain policies and procedures to ensure compliance with applicable regulatory requirements under Regulation E;
- Ensure that disclosures provided to consumers are clear and conspicuous, accurately reflect bank practices, and do not suggest that the bank offers an overdraft program when it does not;
- Confirm a customer’s opt-in is deactivated in the deposit processing platform when he/she does not have access to the overdraft program;
- Verify a customer’s opt-in is deactivated in the deposit processing platform when he/she revokes his/her opt-in election or when the bank terminates the customer’s access to the overdraft program; and
- Notify customers as soon as possible if the bank independently terminates their access to the overdraft program.

Potential Issues with Re-Presentment of Unpaid Transactions

In a separate publication, *Consumer Compliance Supervisory Highlights*, FDIC outlined potential issues with charging multiple NSF fees for re-presentment of unpaid transactions. FDIC found disclosing that one NSF fee would be charged "per item" or "per transaction" is not clearly defined and did not explain that the same transaction might result in multiple NSF fees if re-presented. FDIC stated it believes there is risk of unfairness if multiple fees are assessed for the same transaction in a short period of time without sufficient notice or opportunity for consumers to bring their account to a positive balance.

FDIC also addressed that re-presented transactions have been the subject of recent class action lawsuits involving banks, including FDIC-supervised institutions. The lawsuits typically allege breach of contract due to the omission of important information about when the fee would be assessed.

FDIC again offered suggestions to mitigate risks, including:

- Eliminating NSF fees.
- Declining to charge more than one NSF fee for the same transaction, regardless of whether the item is re-presented.
- Disclosing the amount of NSF fees and how such fees will be imposed, including:
    - Information on whether multiple fees may be assessed in connection with a single transaction;
    - The frequency with which such fees can be assessed; and
    - The maximum number of fees that can be assessed in connection with a single transaction.
- Reviewing customer notification practices related to NSF transactions and the timing of fees to provide the customer with an ability to avoid multiple fees for re-presented items.
- Conducting a comprehensive review of policies, practices, and disclosures related to re-presentments to ensure the manner in which NSF fees are charged is communicated clearly and consistently.
- Working with service providers to retain comprehensive records so that re-presented items can be identified.

Conclusion

WBA would not recommend the use of Regulation E model form A-9 as means to obtain consumers' authorization or opt-in for a force pay transaction. There is not a model form for such transactions and banks need review how best to disclose their practice for force pay transactions with their counsel. For banks offering overdraft programs, banks need be careful how to treat a consumer's opt-in if the opt-in election was provided but access to the overdraft protection coverage has not yet begun and when the bank terminates access to the overdraft program.

WBA also recommends banks review their deposit account disclosures, statement of fees, and account rules documents to further determine how to accurately disclose an NSF fee on a re-presented item, if applicable.

If using FIPCO forms, the WBA 384 Deposit Account Rules document was revised in March 2021 to further clarify that a financial institution may charge a fee each time the same check, transfer request, or withdrawal request is returned unpaid. Language was also added to state that the depositor should review the schedule of fees for a listing and amount of such fees. Additionally, the revised form instruction also set forth that if the user intends to charge a fee each time the same check, transfer request, or withdrawal request is returned unpaid, it is important that the schedule of fees explains the financial institution's intent to charge a fee each time rather than one fee regardless of the number of times the check, transfer request, or withdrawal request is returned unpaid.

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WBA understands identifying transactions for re-presentment are difficult as there is not currently a vendor or system that can assist with such process. However, to help address FDIC's concerns regarding re-presentment, if scrutinized by a regulator for charging multiple NSF fees for a re-presented item, WBA recommends the bank explain to its regulator the actual presentment process and any inability to identify items resubmitted by a merchant for payment.

WBA also recommends banks review when and how they notify customers of an NSF fee or of a negative balance to help demonstrate to regulators that the bank is providing sufficient notice of an NSF fee or negative balance so the consumer can bring a balance positive before a transaction is re-presented by the third party.

The FDIC Dallas Region newsletter and FDIC's *Consumer Compliance Supervisory Highlights* may be viewed at the following links, respectively: https://mcusercontent.com/c419597009ea1cebe5ec3b439/files/920339f7-fc0b-78eb-765d-1503d44bbd78/Dallas_Region_Quarterly_Newsletter_1st_Qtr_March_2022.pdf and www.fdic.gov/regulations/examinations/consumer-compliance-supervisory-highlights/documents/ccs-highlights-march2022.pdf ■

OCC Rule Allows for National Banks and Federal Savings Associations to Request SAR Exemption

The Office of the Comptroller of the Currency (OCC) recently published a final rule to modify the requirements for national banks and federal savings associations to file suspicious activity reports (SARs). The amendments allow OCC to issue exemptions from filing requirements upon request. The final rule harmonizes OCC's legal authority with the preexisting exemption authority of the Financial Crimes Enforcement Network (FinCEN).

Background

All national banks and federal savings associations (collectively, OCC-regulated banks) are required to adopt appropriate security procedures to discourage robberies, burglaries, and larcenies and to assist in identifying and apprehending persons who commit such actions. Such procedures would include the filing of a SAR regarding the actions. Additionally, OCC-regulated banks are required to file a SAR when the bank knows or suspects a violation of federal law or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act (BSA), 31 CFR Chapter X.

New OCC Exemption from SAR Filing Requirement

Regulations for both nationally chartered banks (Part 21.11) and federal savings associations (Part 163.180) have been amended to create an exemption to provide OCC-regulated banks an option to request an exemption from OCC for the filing of a SAR. The request to OCC must be in writing.

In review of the request for an exemption, OCC will consider whether the exemption is consistent with the purposes of BSA (if applicable) and safe and sound banking. OCC may also consider other appropriate factors. If granted, an exemption will apply only as expressly stated by OCC in its exemption.

OCC will respond to an OCC-regulated bank's request in writing. Any exemption granted by OCC will continue for the time specified by OCC. Additionally, OCC may extend the period of time or may revoke an exemption granted at its sole discretion. Before revoking an exemption, OCC will provide written notice to the OCC-regulated bank of its intention to revoke the exemption. Such notice will include the basis for the revocation and will provide an opportunity for the OCC-regulated bank to respond to OCC. OCC will consider any response from its regulated bank before deciding whether or not to revoke an exemption. Finally, OCC will provide written notice of its final decision regarding revocation.

FinCEN Exemption Still Separate Request

The new exemption created by OCC is separate from any SAR filing requirement with FinCEN under its BSA-related rules, 31 CFR 1020.320. Under FinCEN rules, a financial institution must report any transaction if the transaction is conducted or attempted by, at, WBA understands identifying transactions for re-presentment are difficult as there is not currently a vendor or system that can assist with such process. However, to help address FDIC's concerns regarding re-presentment, if scrutinized by a regulator for charging multiple NSF fees for a re-presented item, WBA recommends the bank explain to its regulator the actual presentment process and any inability to identify items resubmitted by a merchant for payment.

WBA also recommends banks review when and how they notify customers of an NSF fee or of a negative balance to help demonstrate to regulators that the bank is providing sufficient notice of an NSF fee or negative balance so the consumer can bring a balance positive before a transaction is re-presented by the third party.

The FDIC Dallas Region newsletter and FDIC's *Consumer Compliance Supervisory Highlights* may be viewed at the following links, respectively: https://mcusercontent.com/c419597009ea1cebe5ec3b439/files/920339f7-fc0b-78eb-765d-1503d44bbd78/Dallas_Region_Quarterly_Newsletter_1st_Qtr_March_2022.pdf and www.fdic.gov/regulations/examinations/consumer-compliance-supervisory-highlights/documents/ccs-highlights-march2022.pdf ■

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In review of the request for an exemption, OCC will consider whether the exemption is consistent with the purposes of BSA (if applicable) and safe and sound banking. OCC may also consider other appropriate factors. If granted, an exemption will apply only as expressly stated by OCC in its exemption.

OCC will respond to an OCC-regulated bank's request in writing. Any exemption granted by OCC will continue for the time specified by OCC. Additionally, OCC may extend the period of time or may revoke an exemption granted at its sole discretion. Before revoking an exemption, OCC will provide written notice to the OCC-regulated bank of its intention to revoke the exemption. Such notice will include the basis for the revocation and will provide an opportunity for the OCC-regulated bank to respond to OCC. OCC will consider any response from its regulated bank before deciding whether or not to revoke an exemption. Finally, OCC will provide written notice of its final decision regarding revocation.

FinCEN Exemption Still Separate Request

The new exemption created by OCC is separate from any SAR filing requirement with FinCEN under its BSA-related rules, 31 CFR 1020.320. Under FinCEN rules, a financial institution must report any transaction if the transaction is conducted or attempted by, at, or through the financial institution and involves or aggregates at least $5,000 (unless the transaction is otherwise exempt under FinCEN's regulations) and the financial institution knows, suspects, or has reason to suspect that the transaction or pattern of transactions of which the transaction is a part:

- Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;

- Is designed, whether through structuring or other means, to evade any requirement of 31 CFR Chapter X or any other regulation promulgated under the BSA;

- Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction, or

- Involves the use of the financial institution to facilitate criminal activity.

Separately, pursuant to OCC regulations Part 21.11 and Part 163.180, OCC-regulated banks must send completed SARs to FinCEN in the following circumstances: (1) insider abuse involving any amount; (2) violations aggregating $5,000 or more where a suspect can be identified; (3) violations aggregating $25,000 or more regardless of potential suspects; and (4) transactions aggregating $5,000 or more that involved potential money laundering or violate BSA.

An OCC-regulated bank that seeks an exemption of filing a SAR from both OCC and FinCEN regulations must submit a written request to both agencies. Each agency will independently determine whether to approve the request. While OCC stated in the preamble of the final rule that it will coordinate with FinCEN, each agency will make its own determination regarding an exemption request.

As a result, under OCC's new exemption rule, with respect to requests for exemptions that will also require relief from the requirements of applicable regulations issued by FinCEN under 31 CFR Chapter X, upon receiving approval from both OCC and FinCEN, the requestor will be relieved of its obligations under Parts 21.11 and 163.80 to the extent stated in OCC and FinCEN exemption approvals.

Conclusion

OCC recently revised its regulations to allow for national banks and federal saving associations to request an exemption from OCC for filing a SAR under OCC regulations, Parts 21.11 and 163.180. An exemption request need be made in writing to OCC and as OCC will base its determination on whether the exemption is consistent with the purposes of BSA (if applicable) and safe and sound banking, WBA recommends banks include details in its request which support how an exemption would meet such factors.

The new exemption created by OCC is separate from any SAR filing requirement with FinCEN under its BSA-related rules, 31 CFR Chapter X. Thus, an OCC-regulated bank that seeks an exemption of filing a SAR from both OCC and FinCEN regulations must submit a written request to both agencies. Upon receiving approval from both OCC and FinCEN, the requestor will be relieved of its obligations under Parts 21.11 and 163.80 to the extent stated in OCC and FinCEN exemption approvals.

The final rule is effective **May 1, 2022**, and may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-05521.pdf ■

Wisconsin Bankers ASSOCIATION

March 2022

Compliance Journal

Special Focus

CFPB Bulletin: Mitigating Harm from Repossession of Automobiles

On **March 3, 2022**, the Bureau of Consumer Financial Protection (CFPB) issued Compliance Bulletin, 2022-04 (Bulletin) regarding repossession of vehicles, and the potential for violations of sections 1031 and 1036 of the Dodd-Frank Act's (DFA's) prohibition in engaging in unfair, deceptive, or abusive acts or practices (collectively, UDAAP) when repossessing vehicles. The Bulletin was applicable as of publication.

The Bulletin consists of activities identified by CFPB from past examination and enforcement actions that it has cited as unfair and deceptive acts or practices under UDAAP. The Bulletin also sets forth CFPB's expectations of how creditors and servicers are to avoid a UDAAP claim.

While CFPB may not be a bank's primary prudential regulator, knowing CFPB's position regarding the activities identified in the Bulletin can help the bank best protect against a similar claim should another prudential banking regulator, or a plaintiff's attorney, adopt a similar interpretation or approach.

When in review of the Bulletin, remember CFPB is addressing UDAAP under federal law. The Bulletin does not comment or take into consideration any requirement under Wisconsin's Consumer Act regarding default, right to cure a default, any notice requirement, other repossession rules under the Consumer Act, or any other Wisconsin-specific state law. Banks need be mindful to also comply with any requirement under Wisconsin law, as applicable.

The following is CFPB's Compliance Bulletin, 2022-04 regarding UDAAP and mitigating harm from repossession of automobiles.

I. Background

In recent months, CFPB has identified that there has been an extremely strong demand for used automobiles. Since the start of the COVID-19 pandemic, the average list price for used automobiles has continued to climb. While there are many factors contributing to high prices, CFPB stated it is concerned that the market conditions might create incentives for risky auto repossession practices, since repossessed automobiles can command higher prices when resold. To mitigate harms from these risks, CFPB has issued the Bulletin to remind market participants about certain legal obligations under federal consumer financial laws.

CFPB explains that to secure an auto loan, lenders require borrowers to give creditors a security interest in the vehicle. If a borrower defaults, a creditor may exercise its contractual rights to repossess the secured vehicle. Servicers collect and process auto loan or lease payments from borrowers and are either creditors or act on behalf of creditors. Generally, servicers do not immediately repossess a vehicle upon default and instead attempt to contact consumers before repossession, usually by phone or mail. Servicers may give consumers in default the opportunity to avoid repossession by making additional payments or promises to pay. Servicers generally use service providers to conduct repossessions. While some repossessions are unavoidable, CFPB stated it pays particular attention to servicers' repossession of automobiles. Loan holders and servicers are responsible for ensuring that their repossession-related practices, and the practices of their service providers, do not violate the law. CFPB stated it intends to hold loan holders and servicers accountable for UDAAPs related to the repossession of consumers' vehicles.

II. Unfair and Deceptive Acts or Practices in Supervision and Enforcement Matters

The Bulletin summarizes the current law and highlights relevant examples of conduct observed during CFPB supervisory examinations or enforcement investigations that may violate federal consumer financial law.

Under DFA, all covered persons or service providers are prohibited from committing unfair, deceptive, or abusive acts or practices in violation of DFA. Under DFA sections 1031 and 1036, an act or practice is unfair when (i) it causes or is likely to cause substantial injury to consumers; (ii) the injury is not reasonably avoidable by consumers; and (iii) the injury is not outweighed by countervailing benefits to consumers or to competition. Whether an act or practice is deceptive is informed by decades of precedent involving Section 5 of the Federal Trade Commission Act.

The DFA prohibits two types of abusive practices. First, materially interfering with the ability of a consumer to understand a term or condition of a product or service is abusive. Second, taking unreasonable advantage of statutorily specified market imbalances is abusive. The market imbalances include: (i) a consumer's lack of understanding of the material risks, costs, or conditions of a product or service; (ii) a consumer's inability to protect their interests in selecting or using a product or service; or (iii) a consumer's reasonable reliance on a covered person to act in their interests.

a. Unfair or Deceptive Practices During the Repossession Process

In its supervisory and enforcement work, CFPB stated it found the following conduct related to repossession of automobiles to be UDAAPs.

Wrongful Repossession of Consumers' Vehicles

Many auto servicers provide options to borrowers to avoid repossession once a loan is delinquent or in default. Failure to prevent repossession after borrowers complete one of the options, where reasonably practicable given the timing of the borrowers' action, may constitute an unfair act or practice. For example, in a public enforcement action, CFPB found that an entity engaged in an unfair act or practice when it wrongfully repossessed consumers' vehicles. (see *In the Matter of Nissan Motor Acceptance Corp.*, 2020-BCFP-0017, Oct. 13, 2020). The servicer told consumers it would not repossess vehicles when they were less than 60 days past due. Additionally, the servicer maintained a policy and told consumers that it would not repossess vehicles of consumers who had entered into an agreement to extend the loan, or who had made a promise to make a payment on a specific date and that date had not passed or who successfully kept a promise to pay. Nevertheless, the servicer repossessed vehicles from hundreds of consumers who had:

- Made and kept promises to pay that brought the account current;
- Made payments that decreased the delinquency to less than 60 days past due;
- Made promises to pay where the date had not passed; or
- Agreed to extension agreements.

Each of the actions taken by consumers should have prevented repossessions of their vehicles. CFPB found the servicer's wrongful repossessions constituted an unfair act or practice, and found the actions caused substantial injury by depriving borrowers of the use of their vehicles. CFPB also found many consumers also experienced consequences such as missed work, expenses for alternative transportation, repossession-related fees, detrimental credit reporting, and vehicle damage during the repossession process. CFPB found such injury was not reasonably avoidable, and the injury was not outweighed by countervailing benefits to the consumer or to competition.

CFPB also identified similar unfair practices in numerous examinations. (see *CFPB Supervisory Highlights*, Issue 16 – Summer 2017; and Issue 17 – Summer 2018). CFPB observed that violations frequently occurred, after consumers acted to prevent repossession, because of one of the following errors:

- Servicers incorrectly coded consumers as delinquent;
- Servicer representatives failed to cancel repossession orders that had previously been communicated to repossession agents; or
- Repossession agents failed to confirm that the repossession order was still active prior to repossessing a vehicle.

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Other Practices Causing Wrongful Repossession
CFPB has also identified other practices related to repossession that resulted in unfair acts or practices. For example, the Bankruptcy Code imposes an automatic stay that bars collection activity, including repossession, from the moment a consumer has filed a bankruptcy petition. CFPB found that when servicers received notice that consumers had filed bankruptcy petitions and their accounts were subject to an automatic stay, the servicers committed an unfair act or practice by repossessing vehicles subject to such automatic bankruptcy stays.

Additionally, CFPB identified that servicers committed an unfair act or practice by wrongfully repossessing vehicles after communicating inaccurate information. For example, CFPB found that some servicers sent consumers letters stating that loans would not be considered past due if the consumer paid the amount due by a specific date. Consumers reasonably expected the servicers not to repossess before the date listed in the letter. When the servicers repossessed the vehicles prior to that date, the servicers committed an unfair act or practice.

Representations of Amounts Owed
CFPB also identified that servicers committed deceptive acts or practices by failing to provide consumers with accurate information about the amount required to bring their accounts current. For example, when consumers called to determine what amount would bring their accounts current, servicing personnel erroneously represented to consumers an amount due that was less than what was actually owed. As a result of the misrepresentation, consumers paid an amount insufficient to avoid delinquency and the consequences of delinquency. This later led to repossessions that would not have occurred had consumers received accurate information. CFPB found the conduct was deceptive because the servicer told consumers that an amount would bring their accounts current when, in fact, that amount would not bring their account current.

b. Unfair or Deceptive Practices That May Lead to Repossession

The following are examples of practices that lead to repossession of consumers' vehicles which CFPB found are UDAAPs.

Applying Payments in a Different Order Than Disclosed to Consumers, Resulting in Repossession
Payment application for auto loans is governed by the finance agreements between servicers and consumers. CFPB found that entities engaged in a deceptive act or practice when they made representations to consumers that payments would be applied in a specific order, and then subsequently applied payments in a different order. For example, CFPB found that servicers represented on their websites that payments would be applied to interest, then principal, then past due payments, before being applied to other charges, such as late fees. Instead, the servicers applied partial payments to late fees first, in contravention of the methodology disclosed on the website. Because servicers applied payments to late fees first, some consumers were deemed more delinquent than they would have been under the disclosed payment allocation order, and the servicers repossessed some consumers' vehicles. Under these circumstances, CFPB found servicers' websites provided inaccurate information about payment allocation order. In some instances, the underlying contract provided the servicer the right to apply payments in any order, which did not immunize the company from liability for the deceptive website content. (see *CFPB Supervisory Highlights*, Issue 24 – Summer 2021).

Unlawful Fees That Push Consumers Into Default and Repossession
CFPB has brought claims under its unfairness authority where unlawful fees push consumers into default and repossession. For example, in a public enforcement action, CFPB found that an entity engaged in an unfair act or practice by operating its force-placed insurance (FPI) program in an unfair manner, in some instances resulting in repossession. (see *In re Wells Fargo Bank, N.A.*, 2018-BCFP-0001, Apr. 20, 2018). The entity purchased duplicative or unnecessary FPI policies and, in some instances, maintained the policies even after consumers had obtained adequate insurance and provided adequate proof of coverage. The conduct caused the entity to charge consumers for unnecessary FPI, resulting in additional fees, and in some instances delinquency or loan default. For some consumers, the additional costs of unnecessary FPI contributed to a default that resulted in the repossession of a consumer's vehicle. Charging unnecessary amounts to consumers and subjecting them to default and repossession caused or was likely to cause substantial injury. CFPB found the injury was not reasonably avoidable and was not outweighed by countervailing benefits. (see also *CFPB Supervisory Highlights*, Issue 24 – Summer 2021).

c. Unfair Practices That May Result in Illegal Fees After Repossession

The following are examples of practices that led to illegal fees after repossession of consumers' vehicles which CFPB found are UDAAPs.

Charging Illegal Personal Property Fees
CFPB has identified an unfair practice concerning illegal personal property fees. Borrowers often keep personal property in the repossessed vehicles. The items often are not merely incidental but can be of substantial practical importance or emotional attachment to borrowers. State law typically requires auto loan servicers and repossession companies to secure and maintain borrowers' property so that it may be returned to the borrower upon request. Some companies charge borrowers for the cost of retaining the property.
In a public enforcement action, CFPB found that an entity engaged in an unfair act or practice by withholding consumers' personal property unless the consumers paid an upfront fee to recover the property. (see *In the Matter of Nissan Motor Acceptance Corp.*, 2020-BCFP-0017, Oct. 13, 2020. Many of the repossession agents employed by the entity imposed fees on consumers for holding personal property in the repossessed vehicles. The agents often refused to return consumers' personal property unless and until the consumers paid the fees. CFPB found that the servicer was responsible for its agents withholding consumers' personal property unless the consumer paid an upfront fee to recover it and thus caused substantial injury that was not reasonably avoidable and not outweighed by countervailing benefits to consumers or competition. In examinations, CFPB also identified this unfair act or practice at other servicers where the servicers withheld consumers' personal property unless they paid an upfront fee. (see *CFPB Supervisory Highlights*, Issue 13 – Fall 2016).

Charging for Collateral Protection Insurance After Repossession
CFPB found that servicers engaged in unfair acts or practices by collecting or attempting to collect force-placed collateral protection insurance (FPI) premiums after repossession even though no actual insurance protection was provided for the periods. FPI automatically terminates on the date of repossession, and consumers should not be charged after such date. Despite this, servicers charged consumers for FPI after repossession in four different circumstances. First, servicers failed to communicate the date of repossession to the FPI service provider due to system errors. Second, servicers used an incorrect formula to calculate the FPI charges that needed to be removed due to the repossession. Third, servicers' employees entered the wrong repossession date into their system of record, resulting in improper termination dates. Fourth, servicers charged consumers, who had a vehicle repossessed and subsequently reinstated the loan, post-repossession FPI premiums, including for the days the vehicle was in the servicer's possession, despite the automatic termination of the policy on the date of repossession. CFPB found the errors caused consumers substantial injury because they paid amounts they did not owe or were subject to collection attempts for amounts they did not owe, injury was not reasonably avoidable because consumers did not control the servicers' cancellation processes, and the substantial injury to consumers was not outweighed by any countervailing benefits to consumers or competition. (see *CFPB Supervisory Highlights*, Issue 24 – Summer 2021).

III. CFPB's Expectations

As explained in greater detail above, CFPB has held auto lenders, loan holders, and servicers accountable if they or their agents commit UDAAPs when repossessing automobiles, including when they:

- Repossessed vehicles if consumers' loan account is current, even if there was a prior delinquency;
- Repossessed vehicles if consumers entered an agreement to extend the loan;
- Repossessed vehicles if consumers followed any instructions the company said would result in avoiding repossession;
- Repossessed vehicles from consumers who have filed for bankruptcy, and thus are protected by an automatic stay of collection activity;
- Repossessed vehicles as a result of processing payments in a different order than had been communicated to consumers;
- Repossessed vehicles after unlawful fees pushed the consumer's account into default;
- Withhold personal property found in repossessed vehicles until consumers pay an upfront fee to recover the property; and
- Charged for collateral protection insurance after a vehicle is repossessed.

To prevent these unfair, deceptive, or abusive acts or practices, CFPB recommends entities should consider doing the following:

- Review policies and procedures, including call scripts, to ensure that they provide employees with accurate information about steps consumers can take to prevent repossession;
- Review policies and procedures regarding cancellation of repossession orders to ensure that there is an appropriate process for cancelling repossessions if consumers take steps that should result in cancellation;
- Ensure prompt communications between the servicer and repossession service provider when the servicer cancels a repossession. For example, servicers may call repossession service providers to confirm cancelation or use mobile phone applications that push cancellation updates to repossession service providers' phones;
- Monitor repossession service providers for compliance with repossession cancellations;

- Incorporate monitoring of wrongful repossession in regular monitoring and audits of communications with consumers;
- Ensure that the entity has a corrective action program to address any violations identified and to reimburse consumers for the direct and indirect costs incurred as a result of unlawful repossessions when appropriate;
- Review payment allocation policies and procedures to validate that they are consistent with the payment allocation order disclosed in contracts and other consumer facing disclosures, such as websites;
- Monitor for illegal fees charged after repossession;
- Review consumer contracts to validate that any fees charged to consumers are authorized under the terms of applicable contracts;
- Review consumer complaints regarding repossession and ensure there is an appropriate channel for receiving, investigating, and properly resolving consumer complaints relating to wrongful repossession and illegal fees after repossession;
- Perform regular reviews of service providers, including repossession vendors, as to their pertinent practices; or
- Monitor any FPI program to ensure that consumers are not charged for unnecessary FPI. This may include review of FPI cancellation rates.

Conclusion

CFPB stated it will continue to review closely the practices of entities repossessing automobiles for potential UDAAPs, including the practices described above. CFPB also stated it intends to use all appropriate tools to hold entities accountable if they engage in UDAAPs in connection with the practices described in the Bulletin.

WBA anticipates other prudential banking regulators may take a similar approach as outlined in the Bulletin should such activities be found in an examination. Banks should take into consideration the actions steps highlighted above.

The Bulletin may be viewed at: www.govinfo.gov/content/pkg/FR-2022-03-03/pdf/2022-04508.pdf ■

New Attempts By California Law Firm Allege Accessibility Violation of Bank Websites

WBA has learned of recent activity by a California law firm contacting Wisconsin banks alleging the bank's website is in violation of the California Unruh Act. The law firm, Pacific Trial Attorneys, engaged in similar activity in Wisconsin back in 2018.

The letter alleges the firm has been retained by a blind consumer to file suit against the bank, claiming the bank's website is not fully accessible to blind users. The letter cites a California court case which held "disability access laws apply to commercial websites, including online-only businesses."

If a bank receives such a letter, it is important to contact bank's legal counsel immediately. This law firm has a history of sending these letters to banks and other businesses and then promptly files lawsuits against the bank/business, as is threatened in the letter. WBA suggests banks not treat these letters as a "fishing expedition" but, rather, take them very seriously and work to respond with the advice of bank counsel, promptly.

The letter references a violation of California law. Bank's counsel need be in review of bank's products and activities to identify whether the California law is applicable to the bank. While in review of bank's website, WBA recommends banks also consider whether its website is in violation of the Web Content Accessibility Guidelines (Guidelines) as the California claim could potentially change from a violation of California law to a claim regarding violation of the Americans with Disabilities Act (ADA).

WBA also suggests banks work with their website vendor to be sure the bank's website complies with any relevant law, including the Guidelines and, if not, how quickly it can be changed to comply.

WBA further suggests that if it is not already in the bank's legal contract with its website vendor, banks should add provisions to the contract to place the burden of ensuring the bank's compliance with the Guidelines on the vendor. And, if any legal demand or litigation is initiated against the bank claiming a violation of ADA or the Guidelines, that the vendor is wholly responsible.

WBA understands that receiving these kinds of letters from plaintiffs' law firms is not only frustrating but can be a significant distraction from normal operations. However, as more commerce is done electronically including through bank websites, it is important to not lose sight of relevant law, including ADA-related guidelines, to the same degree banks follow applicable requirements

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for physical access to the bank. There is not going to be any legislative change that would wholly exempt bank websites from any compliance with guidelines around providing access to the public including persons with disabilities. Consequently, it is very important for banks to promptly respond to any such letter it may receive.

Both the ICBA and ABA have materials on their respective websites available for members on the topic of ADA digital accessibility. WBA first wrote on the topic of ADA digital accessibility in the January 2017 issue of *Wisconsin Banker*. General information about the Guidelines may be viewed at: https://www.w3.org/WAI/standards-guidelines/wcag/

Finally, WBA is collecting letters received by its member banks. If you have received a letter, we would appreciate you sending a copy to WBA's **Scott Birrenkott** at sbirrenkott@wisbank.com. If you have any questions or would like to discuss this further, please contact WBA Legal at wbalegal@wisbank.com or 608-441-1200. ■

Reminder of Upcoming Compliance Dates for Recently Finalized Interagency Computer-Security Incident Notification Requirements

As first reported in the December 2021 *WBA Compliance Journal*, banks are reminded of the **April 1, 2022** compliance date and **May 1, 2022** mandatory compliance date for the recently issued interagency final rule which requires a banking organization to notify its primary federal regulator of computer-security incidents.

In short, a banking organization must notify its primary federal regulator's supervisory office, or federal regulator's designated point of contact, about a notification incident through email, telephone, or other similar methods that the primary federal regulator may prescribe as soon as possible and no later than 36 hours after the banking organization determines that a notification incident has occurred.

If a banking organization has not already done so, between now and May 1, a banking organization need consider whether any current procedures to identify computer incidents need be updated in light of the recent final rule. Banking organizations with bank service providers should also review existing notification duties to ensure the providers can also identify a computer-response incident, as the term is defined in the final rule, and can notify the banking organization as required in the final rule.

The final rule may be viewed at: www.govinfo.gov/content/pkg/FR-2021-11-23/pdf/2021-25510.pdf

Past *WBA Compliance Journals*, including the December 2021 edition, may be found on the WBA website at: www.wisbank.com/resources/wba-publications/ ■

Regulatory Spotlight

CFPB Updates Rules of Practice for Adjudication Proceedings.

The Consumer Financial Protection Bureau (CFPB) issued a procedural rule to update its Rules of Practice for Adjudication Proceedings. The rule expands the opportunities for parties in adjudication proceedings to conduct depositions. It also contains various amendments regarding timing and deadlines, content of answers, scheduling conference, bifurcation of proceedings, process for deciding dispositive motions, and requirements for issue exhaustion, as well as other technical changes. The procedural rule is effective **02/22/2022**. Comments are due **04/08/2022**. The procedural rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-02-22/pdf/2022-02863.pdf. *Federal Register*, Vol. 87, No. 35, 02/22/2022, 10028-10056.

CFPB Publishes Compliance Bulletins on EFTA's Compulsory Use Prohibition and Government Benefit Accounts, Student Loan Servicing, and Automobile Repossessions.

- CFPB published a Compliance Bulletin (Bulletin) regarding the Electronic Fund Transfer Act (EFTA)'s compulsory use

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Regulatory Spotlight

CFPB Updates Rules of Practice for Adjudication Proceedings.

The Consumer Financial Protection Bureau (CFPB) issued a procedural rule to update its Rules of Practice for Adjudication Proceedings. The rule expands the opportunities for parties in adjudication proceedings to conduct depositions. It also contains various amendments regarding timing and deadlines, content of answers, scheduling conference, bifurcation of proceedings, process for deciding dispositive motions, and requirements for issue exhaustion, as well as other technical changes. The procedural rule is effective **02/22/2022**. Comments are due **04/08/2022**. The procedural rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2022-02-22/pdf/2022-02863.pdf. *Federal Register*, Vol. 87, No. 35, 02/22/2022, 10028-10056.

CFPB Publishes Compliance Bulletins on EFTA's Compulsory Use Prohibition and Government Benefit Accounts, Student Loan Servicing, and Automobile Repossessions.

- CFPB published a Compliance Bulletin (Bulletin) regarding the Electronic Fund Transfer Act (EFTA)'s compulsory use

Wisconsin Bankers Association

February 2022

Compliance Journal

Special Focus

Revisiting Important Flood Considerations

Introduction

WBA has become aware that the Federal Deposit Insurance Corporation (FDIC) has recently once again been closely examining flood insurance issues. Specifically, they have focused on cross-collateralization and overall coverage considerations, including contents coverage. This article discusses those issues, in addition to practical considerations, regardless of an institution's primary regulatory agency. While these flood issues are not new, it is important that institutions review their flood procedures in light of renewed regulator interest.

Background

Flood insurance regulations require that covered institutions shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan. The amount of flood insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property.

In some cases, a financial institution may utilize cross-collateralization language, resulting in multiple loans being secured by a property located in a special flood hazard area (SFHA). This can affect when the flood rules are triggered, as well as the determination of the required amount of flood insurance. Furthermore, if a lender secures a loan with a building located in a SFHA, and takes a security interest in the contents, flood insurance is required. These issues are discussed below.

Cross-Collateralization

When a financial institution has a pre-existing mortgage, it should consider whether this mortgage secures any future obligations. This could be the result of future advance language or other cross-collateralization clauses. If a financial institution has a loan secured by property in a flood zone, and utilizes such language, then it should consider whether future loans are secured by that same property in a flood zone. Such situations will trigger flood rules, which will then need to be addressed. It is important to understand the specific function of the language, as it may also include collateral disclaimers to avoid flood complications.

For example, when making a loan secured by a WBA 428 Real Estate Mortgage, the mortgage document states that the mortgage will secure certain future advances. However, in general, most WBA consumer notes disclaim principal dwellings as collateral, unless the principal dwelling is specifically described in the note or agreement. So, a pre-existing mortgage on a principal dwelling does not secure a future consumer note or agreement unless the note or agreement specifically identifies the dwelling.

As a general matter, for consumer loans, if the mortgage covers a principal dwelling, and the principal dwelling is identified by future advance as security for the note, the lender will have presumably already considered flood requirements. However, there may also be cases where the lender makes a loan, such as a vehicle loan, and the lender has a pre-existing real estate mortgage, where the car loan may also be secured by the pre-existing mortgage. Similarly, a commercial loan to an individual borrower may also be secured by a pre-existing mortgage from that borrower. If the lender does take a security interest in a building or mobile home by virtue of a pre-existing mortgage, the lender will trigger flood rules, including the requirement to deliver flood notices, and complete the Standard Flood Hazard Determination Form.

Financial institutions might also utilize collateral disclaimers. If a lender is looking to specifically exclude certain collateral for flood purposes, or if lender is otherwise unable to determine whether a loan may be secured by a pre-existing mortgage, the lender may choose to disclaim as collateral any real estate or mobile home within a SFHA. Certain WBA forms include such a disclaimer.

By way of example of the above, assume a lender makes a mortgage loan on the WBA 458 Mortgage Note, which identifies on the face of the note that the collateral is a residential dwelling. The dwelling is in a SFHA.

The Mortgage Note also includes a standard cross-collateral provision on the reverse side of the form providing, in part, that the Mortgage Note is also secured by:

> "...all existing and future security agreements covering personal property (other than a dwelling, unless the security agreement granting a security interest in the dwelling is disclosed on the reverse side), between Lender and any of us..."

Under this cross-collateral provision, any personal property taken as collateral from the borrower at a later time (other than a dwelling), also secures the Mortgage Note.

Assume that a second consumer loan is made to the same borrower and the second loan is secured by a motor vehicle. This second loan to the borrower may be documented on WBA 454L Consumer Simple Interest Note and Chattel Security Agreement or a WBA 455 Consumer Universal Note (Consumer Note). The vehicle taken as collateral for the subsequent Consumer Note also secures the Mortgage Note by virtue of the cross-collateral clause in the Mortgage Note (and the security agreement).

As mentioned above, the flood rules provide that a lender shall not make, increase, extend, or renew a loan secured by a building or mobile home located or to be located in an SFHA unless the building or mobile home and any personal property securing that loan are covered by flood insurance for the term of the loan. Note that the trigger for the flood rules is that the lender has made, increased, extended, or renewed a loan secured by a building or mobile home located or to be located in a SFHA. If one of the triggering events occurs, then the building or mobile home and any personal property securing the loan must be covered by flood insurance for the term of the loan and the other requirements of the flood rule, such as notice to the borrower of property in a SFHA, apply. However, the first step is the trigger. No increase in flood insurance or notice to the borrower is required if the flood rules are not triggered.

In the case of the loans described directly above, the lender must comply with the flood rules when it makes the original home loan secured by a home located in a SFHA. When the car loan is made the lender must determine whether it is making, increasing, extending, or renewing a loan secured by a building or mobile home in a SFHA.

1. The Home Loan. The Bank does not make, increase, extend, or renew the existing home loan when it makes the car loan. True, the collateral securing the home loan increased because the car also secured the home loan. But, increasing collateral for a loan is not a trigger for the Flood Rules. Therefore, as to the home loan, no triggering event occurs at the time of the car loan.

2. The Car Loan. Likewise, the Bank does not make, increase, extend, or renew a loan secured by a building located in a SFHA when it makes a car loan using a Consumer Note. As to collateral other than the car, the cross-collateral clause on the reverse side of the Consumer Note disclaims any dwelling as collateral unless described in the appropriate blank in the Consumer Note. If the home in the SFHA is not described in the Consumer Note, the home will not secure the car loan. This means the car loan is not secured by real estate or a dwelling located in a SFHA and the flood rules are not triggered for the car loan.

Lenders are reminded that commercial and agricultural loans are treated differently. The cross-collateral clauses in the WBA commercial and agricultural loan documents are broader than they are in the consumer loan documents. The WBA commercial and agricultural loan documents generally provide that the collateral securing a loan to a commercial or agricultural borrower secures all loans to the borrower even those made after the initial loan. Likewise, collateral provided by guarantors may secure commercial and agricultural loans. In the commercial or agricultural context, if one loan to a borrower

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is secured by property located in a SFHA, the cross-collateral clauses are likely to trigger the flood rules when a second loan is made to that borrower. Lenders should continue to review commercial and agricultural loans for compliance with the flood rules whenever a new loan is made. In the commercial or agricultural loan context, the lender must determine whether collateral is covered by sufficient flood insurance and whether the notice to borrower is required by the flood rules, by reviewing all collateral for a loan, taking into account the broad cross-collateral clause in the WBA commercial and agricultural loan forms.

Because cross-collateralization and any type of collateral disclaimers (if utilized) depends upon the specific language used, and how financial institutions document their loans, lenders should evaluate the language within their notes and security agreements, and loan policy, to determine whether flood rules are triggered.

Lastly, in a past *FDIC Quarterly Newsletter*, FDIC also specifically addressed the impact of Maximum Obligation Limit provisions within security instruments. A Maximum Obligation Limit provision is one which permits lenders to advance funds to pay for flood insurance premiums and fees, among other things, as additional debt to be secured by the property. FDIC indicated that the presence of a Maximum Obligation Limit provision in security instruments does not limit any potential cross-collateralization exposure.

Flood Insurance Coverage

The amount of flood insurance required must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property under the National Flood Insurance Act. If a financial institution's note or security agreement includes cross-collateralization language, resulting in multiple loans being secured by a property located in a SFHA, the collective outstanding principal balance of those loans must be accounted for in the flood insurance calculation. Lenders should also note that when determining the amount of flood insurance required, the flood rules do not distinguish between commercial and consumer purpose loans. Furthermore, flood insurance extends to any personal property securing a loan.

For example, if a lender secures the loan with a building located in a SFHA for which flood insurance is available, and the lender also takes a security interest in the contents, flood insurance is required. Financial institutions should consider the language within their loan agreement to determine whether any contents are taken as collateral for a loan. Also note that flood insurance is required depending on whether those contents secure the loan, regardless of whether the security interest is perfected.

FDIC has indicated that the contents and building will be considered to have a sufficient amount of flood insurance coverage for regulatory purposes so long as some reasonable amount of insurance is allocated to each category. Eligibility requirements for contents, as well as the maximum amount of insurance available, is also included within the National Flood Insurance Program's Flood Insurance Manual, which is included at the end of this article. Additional information and examples on contents insurance can be found within the Interagency Flood Insurance Questions and Answers, also included at the end of this article.

Conclusion

While these concepts are not new, given the recent focus by federal regulators, financial institutions might consider reviewing their cross-collateralization and contents language in notes and security instruments and consider the impact on flood insurance compliance, as necessary.

Additional Resources

Flood Insurance Manuals and Handbooks: https://www.fema.gov/flood-insurance/work-with-nfip/manuals
Interagency Flood Q&As 2009: https://www.govinfo.gov/content/pkg/FR-2009-07-21/pdf/E9-17129.pdf
Interagency Flood Q&As 2011: https://www.govinfo.gov/content/pkg/FR-2011-10-17/pdf/2011-26749.pdf

(Note: In 2021, the agencies proposed revisions to the interagency flood Q&As; however, as those have not been finalized at time of publication of this article, the 2021 flood Q&As have not been included.) ■

Wisconsin Bankers ASSOCIATION

January 2022

Compliance Journal

Special Focus

CFPB Finalizes Regulation Z Rule to Facilitate LIBOR Transition

The Bureau of Consumer Financial Protection (CFPB) issued a final rule to amend Regulation Z generally to address the anticipated sunset of LIBOR, which is expected to be discontinued for most U.S. dollar (USD) tenors in June 2023. The final rule is effective **April 1, 2022**.

Many creditors currently use USD LIBOR as an index for calculating rates for open-end and closed-end products. CFPB has amended open-end and closed-end provisions to provide examples of replacement indices for LIBOR indices that meet certain Regulation Z standards. CFPB has also amended Regulation Z to permit creditors for home equity lines of credit (HELOCs) and card issuers for credit card accounts to transition existing accounts that use a LIBOR index to a replacement index on or after April 1, 2022, if certain conditions are met.

The final rule also addresses change-in terms notice provisions for HELOCs and credit card accounts and how they apply to accounts transitioning away from using a LIBOR index, amends Regulation Z to address how the rate reevaluation provisions applicable to credit card accounts apply to the transition from using a LIBOR index to a replacement index, and to revise post-consummation sample notices for certain closed-end variable rate loans, among other changes.

The following article presents a summary of key portions of CFPB's LIBOR transition final rule. The first section covers the background of LIBOR, which is helpful in understanding its significance in relation to lending operations, the context for its transition, and, ultimately, its relation to Regulation Z requirements. The following sections summarize changes made by CFPB's final rule. The summary is intended to assist creditors transition from using LIBOR by identifying how Regulation Z requirements are impacted by such change.

LIBOR Background

Introduced in the 1980s, LIBOR (originally an acronym for London Interbank Offered Rate) was intended to measure the average rate at which a bank could obtain unsecured funding in the London interbank market for a given period, in a given currency. LIBOR is calculated based on submissions from a panel of contributing banks and published every London business day for five currencies: USD, British pound sterling (GBP), euro (EUR), Swiss franc (CHF), and Japanese yen (JPY)), and for seven tenors, 6 for each currency (overnight, 1-week, 1-month, 2-month, 3-month, 6-month, and 1-year), resulting in 35 individual rates (collectively, LIBOR). As of September 2021, the panel for USD LIBOR is comprised of sixteen banks, and each bank contributes data for all seven tenors. In 2017, the chief executive of the U.K. Financial Conduct Authority (FCA), which regulates LIBOR, announced that it did not intend to persuade or compel banks to submit information for LIBOR past the end of 2021 (subsequently extended to June 30, 2023, for certain USD LIBOR tenors only) and that the panel banks had agreed to voluntarily sustain LIBOR until then in order to provide sufficient time for the market to transition from using LIBOR indices to alternative indices. In March 2021, FCA announced cessation dates for all LIBOR indices. The bank panels are scheduled to end immediately after December 31, 2021, for the 1-week and 2-month USD LIBOR indices and immediately after June 30, 2023, for the remaining USD LIBOR indices. After these dates, representative LIBOR indices will no longer be available.

Financial institutions have used USD LIBOR as a common benchmark rate for a variety of adjustable-rate consumer financial products, including mortgages, credit cards, HELOCs, and student loans. Typically, the consumer pays an interest rate that is calculated as the sum of a benchmark index and a margin. For example, a consumer may pay an interest rate equal to the 1-year USD LIBOR plus two percentage points. Financial institutions have been developing plans and procedures to transition from the use of LIBOR indices to replacement indices for products that are being newly issued and existing accounts that were originally benchmarked to a LIBOR index. In some markets, such as for HELOCs and credit cards, the vast majority of newly originated lines of credit are already based on indices other than a LIBOR index.

Open-End Credit Provisions

CFPB has adopted several amendments to the open-end credit provisions in Regulation Z to address the anticipated sunset of LIBOR.

Choosing a Compliant Replacement Index for LIBOR

First, the final rule sets forth a detailed roadmap for HELOC creditors and card issuers to choose a compliant replacement index for the LIBOR index. Regulation Z already permits HELOC creditors and card issuers to change an index and margin they use to set the annual percentage rate (APR) on a variable-rate account under certain conditions, when the original index becomes unavailable or is no longer available. CFPB determined, however, that consumers and creditors would benefit substantially if HELOC creditors and card issuers could transition away from a LIBOR index before LIBOR is expected to become unavailable.

As a result of the final rule, HELOC creditors and card issuers can transition away from using the LIBOR index to a replacement index on or after **April 1, 2022**, before LIBOR is expected to become unavailable. To accomplish this, the final rule imposes certain requirements on selecting a replacement index. HELOC creditors and card issuers must ensure that the APR calculated using the replacement index is substantially similar to the rate calculated using the LIBOR index, based generally on the values of these indices on October 18, 2021. HELOC creditors and card issuers may select a replacement index that is newly established and has no history or an index that is not newly established and has historical fluctuations substantially similar to those of the LIBOR index.

The final rule provides details on how to determine whether a replacement index has historical fluctuations that are substantially similar to those of a particular LIBOR index for HELOCs and credit card accounts. Specifically, the final rule provides examples of the type of factors to be considered in whether a replacement index meets the Regulation Z "historical fluctuations are substantially similar" standard.

CFPB also has determined that the prime rate published in the *Wall Street Journal* (Prime) has historical fluctuations substantially similar to those of the 1-month and 3-month USD LIBOR indices. In addition, CFPB has determined that spread-adjusted 4 indices based on SOFR recommended by the Alternative Reference Rates Committee (ARRC) for consumer products to the replace 1-month, 3-month, or 6-month USD LIBOR index have historical fluctuations that are substantially similar to those of the applicable USD LIBOR index they are intended to replace.

The new provisions that detail specifically how HELOC creditors and card issuers may replace a LIBOR index with a replacement index for accounts on or after April 1, 2022, are set forth in §1026.40(f)(3)(ii)(B) for HELOCs and §1026.55(b)(7)(ii) for credit card accounts. Financial institutions needing to identify a replacement index for HELOCs and credit cards accounts should carefully review the steps set forth in Regulation Z.

The ARRC has indicated that the SOFR-based spread-adjusted indices recommended by ARRC for consumer products to the replace 1-month, 3-month, 6-month, or 1-year USD LIBOR index will not be published until Monday, **July 3, 2023**, which is the first weekday after Friday, **June 30, 2023**, when LIBOR is currently anticipated to sunset for the USD LIBOR tenors. However, as CFPB wishes to facilitate an earlier transition for HELOC creditors or card issuers that may want to transition to an index other than the SOFR-based spread-adjusted indices recommended by ARRC for consumer products, CFPB has also made these provisions effective on **April 1, 2022**.

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The final rule also makes clarifying changes to existing Regulation Z provisions on the replacement of an index when the index becomes unavailable. These changes are set forth in §1026.40(f)(3)(ii)(A) for HELOCs and in §1026.55(b)(7)(i) for credit card accounts.

Change-in-Term Notice Requirements

The final rule revises change-in-terms notice requirements for HELOCs and credit card accounts to notify consumers how the variable rates on their accounts will be determined going forward after the LIBOR index is replaced.

Generally, under existing change-in-term notice requirements for HELOCs, creditors were not required to provide an advance notice if an APR or margin decreased as a result of the change. However, in promulgating its rule, CFPB believes that when a creditor for a HELOC that is subject to §1026.40 is replacing the LIBOR index and adjusting the margin as permitted by §1026.40(f)(3)(ii)(A) or §1026.40(f)(3)(ii)(B), it is beneficial for consumers to receive notice not just of the replacement index, but also any adjustments to the margin, even if the margin is decreased. The information will help ensure that consumers are notified of the replacement index and any adjusted margin (even a reduction in the margin) so that consumers will know how the variable rates on their accounts will be determined going forward after the LIBOR index is replaced. Otherwise, a consumer that is only notified that the LIBOR index is being replaced with a replacement index that has a higher index value but is not notified that the margin is decreasing could reasonably but mistakenly believe that the APR on the plan is increasing.

The final rule ensures that the change-in-terms notices for these accounts will disclose the index that is replacing the LIBOR index and any adjusted margin that will be used to calculate a consumer's rate, regardless of whether the margin is being reduced or increased. These changes are effective **April 1, 2022**.

Regulation Z comment 9(c)(1)(ii)–3 permits creditors for HELOCs subject to §1026.40 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 pursuant to §1026.40(f)(3)(ii)(A) or §1026.40(f)(3)(ii)(B) earlier than **October 1, 2022**, starting on or after **April 1, 2022**. CFPB encourages creditors to include this information in change-in-terms notices provided earlier than October 1, 2022, starting on or after April 1, 2022, even though they are not required to do so, to ensure that consumers are notified of how the variable rates on their accounts will be determined going forward after the LIBOR index is replaced.

For the same reasons that CFPB adopted the revisions to §1026.9(c)(1)(ii) for HELOCs, CFPB believes that when a creditor for plans other than HELOCs subject to §1026.40 is replacing the LIBOR index and adjusting the margin as permitted by §1026.55(b)(7)(i) or §1026.55(b)(7)(ii), it is beneficial for consumers to receive notice not just of the replacement index but also any adjustments to the margin, even if the margin is decreased. Informing consumers of the replacement index and any adjusted margin (even a reduction in the margin) tells consumers how the variable rates on their accounts will be determined going forward after the LIBOR index is replaced. The revisions to §1026.9(c)(2)(v)(A) are also effective **April 1, 2022**, with a mandatory compliance date of **October 1, 2022**.

The final rule does not provide sample or model forms for the change-in-terms notices as CFPB believes that sample or model forms for such a notice are not necessary or warranted. The change-in-terms notice is not a new requirement. CFPB believes that §1026.9(c)(1) and the related commentary provide sufficient information for creditors to understand change-in-terms notice requirements without the need for sample or model forms.

While not sample or model language, CFPB did provide additional details on how a creditor may disclose information about the periodic rate and APR in a change-in-terms notice for HELOCs and credit card accounts when the creditor is replacing a LIBOR index with the SOFR-based spread-adjusted index recommended by ARRC for consumer products to replace 1-month, 3-month, or 6-month USD LIBOR index in certain circumstances. The details are set forth in comment 9(c)(1)–4 for HELOCs and in comment 9(c)(2)(iv)–2.ii for credit card accounts.

Exception for Credit Card Account Rate Reevaluation

The final rule created an exception from the rate reevaluation provisions applicable to credit card accounts. Currently, when a card issuer increases a rate on a credit card account, the card issuer generally must complete an analysis reevaluating the rate increase every six months until the rate is reduced to a certain degree. To facilitate compliance, the final rule adds an exception from these requirements for increases that occur as a result of replacing a LIBOR index using the specific provisions described in the rule for transitioning from a LIBOR index or as a result of the LIBOR index becoming unavailable. The exception is set forth in §1026.59(h)(3).

The exception would not apply to rate increases that are already subject to the rate reevaluation requirements prior to the transition from the LIBOR index. The final rule also addresses cases where the card issuer was already required to perform a rate reevaluation review prior to transitioning away from LIBOR and LIBOR was used as the benchmark for comparison for purposes of determining whether the card issuer can terminate the six-month reviews. To facilitate compliance, the final rule addresses how a card issuer can terminate the obligation to review where the rate applicable immediately prior to the increase was a variable rate calculated using a LIBOR index. The changes are set forth in §1026.59(f)(3).

Post Consummation Disclosures for Closed-End Credit

Regulation Z §1026.20 includes disclosure requirements regarding post consummation events for closed-end credit. Section 1026.20(a) and its commentary define when a refinancing occurs for closed-end credit and provide that a refinancing is a new transaction requiring new disclosures to the consumer. Comment 20(a)–3.ii.B explains that a new transaction subject to new disclosures results if the creditor adds a variable-rate feature to the obligation, even if it is not accomplished by the cancellation of the old obligation and substitution of a new one. The comment also states that a creditor does not add a variable-rate feature by changing the index of a variable-rate transaction to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists. To clarify comment 20(a)–3.ii.B, CFPB added an illustrative example, which would indicate that a creditor does not add a variable-rate feature by changing the index of a variable-rate transaction from the 1-month, 3-month, 6-month index to the SOFR-based spread-adjusted index recommended by the ARRC for consumer products to replace the 1- month, 3-month, 6-month USD LIBOR index respectively because the replacement index is a comparable index to the corresponding USD LIBOR index. The clarifying comment is helpful as it allows a creditor to replace LIBOR indices with the respective SOFR-based spread-adjusted indices recommended by the ARRC for consumer products without triggering refinancing requirements under Regulation Z.

In its rulemaking CFPB stated that it is reserving judgment about whether to include references to a 1-year USD LIBOR index and its replacement index in various comments; CFPB stated it will consider whether to finalize comments proposed on that issue in a supplemental final rule once it obtains additional information. The ARRC plans to announce no later than **June 30, 2022**, which SOFR-based spread-adjusted replacement index for consumer products it will recommend to replace the 1-year USD LIBOR.

The final rule also updated the interest rate adjustment sample forms used for certain closed-end adjustable rate mortgages (ARMs). The updated forms replace LIBOR references with references to a SOFR-based index. The final rule also adds a date at the top of the sample form H–4(D)(4) that can be used for complying with §1026.20(d) concerning ARMs. The effective date of the revised sample forms in H–4(D)(2) and H–4(D)(4) in Appendix H is **April 1, 2022**. With respect to sample form H– 4(D)(4) in Appendix H, from **April 1, 2022**, through **September 30, 2023**, creditors, assignees, or servicers will have the option of using a format substantially similar to form H–4(D)(4) either in effect prior to April 1, 2022 (that does not include the date at the top of the form and is denoted as "Legacy Form" in Appendix H), or the form that becomes effective on April 1, 2022 (that includes the date at the top of the form and is denoted as ''Revised Form'' in Appendix H). Both versions of the forms will be available in Appendix H through **September 30, 2023**, to accommodate the fact most tenors of USD LIBOR are not expected to be discontinued until June 2023.

Starting on or after **October 1, 2023**, only creditors, assignees, or servicers using a format substantially similar to the form that becomes effective on **April 1, 2022**, that includes a date at the top of the form, will be deemed to be in compliance. Accordingly, the version of form H– 4(D)(4) in effect prior to April 1, 2022, will be removed from Appendix H and cannot be used to demonstrate compliance with §1026.20(d).

Amendment to Loan Estimate Content Disclosure

Regulation Z §1026.37 provides rules for content of the Loan Estimate Disclosure. Section 1026.37(j) addressees the Adjustable Interest Rate Table in the Loan Estimate, and 1026.37(j)(1) the disclosure of the index and margin within that table. Comment 1 to §1026.37(j)(1) has been revised in anticipation of the discontinuation of LIBOR. CFPB has amended the example in comment 37(j)(1)-1 to provide that "SOFR" may be disclosed instead of Secured Overnight Financing Rate. This is a similar approach CFPB took when it allowed for "LIBOR" instead of London Interbank Offered Rate in that area of the disclosure.

Conclusion

CFPB has issued a final rule to amend Regulation Z for both open-end and closed-end credit to address the anticipated sunset of LIBOR. The effective date of the final rule is **April 1, 2022**. The mandatory compliance date for revisions to change-in-term notice requirements in §1026.9(c)(1)(ii) and (c)(2)(v)(A) is **October 1, 2022**. The final rule provides helpful examples for creditors to determine a replacement index for LIBOR in compliance with Regulation Z requirements.

The final rule also updated the interest rate adjustment sample forms used for certain closed-end ARMs under §1026.20(d) and (c). The updated forms replace LIBOR references with references to a SOFR-based index. Given that most USD LIBOR tenors will not sunset until **June 30, 2023**, creditors have the option to rely on either a form similar to current sample forms (referred to as Legacy Form) or may use updated sample forms (referred to as Revised Form) beginning **April 1, 2022**, through the sunset date **September 30, 2023**. Beginning **October 1, 2023**, creditors may only rely on a form which is substantially similar to the updated sample forms provided in the final rule to be deemed in compliance. The sample forms, found in Appendix H, have been marked to designate the dates for which each may be used.

Resources

The final rule may be viewed at: www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25825.pdf

A series of frequently asked questions (FAQs) regarding the final rule may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_libor-transition_faqs.pdf

An Executive Summary of the final rule may be viewed at:
https://files.consumerfinance.gov/f/documents/cfpb_libor-transition_executive_summary_2021-12.pdf

CFPB Director Chorpa's statements regarding the final rule, including a statement that no new financial contracts may reference LIBOR as the relevant index after the end of 2021, and that starting in June 2023, LIBOR can no longer be used for existing financial contracts may be viewed at: www.consumerfinance.gov/about-us/newsroom/statement-of-director-rohit-chopra-on-libor-transition-rule/ ■

Judicial Spotlight

WI Supreme Court Finds Garage is Part of Residence Used by Consumer as Dwelling under WCA

In a four-three opinion filed in early January, the Wisconsin Supreme Court concluded that a "dwelling used by the customer as a residence" under the Wisconsin Consumer Act (WCA) includes a garage attached to the residential building in which the customer lives for purposes of rules that need be followed when creditors proceed with nonjudicial repossession.

On behalf of the membership, WBA participated as an *amicus curie* in the case of *Duncan* v *Asset Recovery Specialists, Inc.* as the case involved the interpretation of statutory language used within the repossession rules of the WCA. This case was first reported on in the November 2020 edition of the *WBA Compliance Journal.*

The facts of the case were undisputed by the parties and include that Duncan purchased a vehicle from a dealership; she financed the purchase with a loan. Duncan failed to make payments that came due and eventually was in default. The vehicle served as collateral for the loan and the bank followed the procedure allowed under Wisconsin law for a "nonjudicial" repossession under Wis. Stat. §425.206(1)(d). The bank met all statutory requirements to proceed with nonjudicial repossession and ultimately retained Asset Recovery Specialists to repossess Duncan's vehicle. At the time, Duncan rented an apartment unit in a multi-story apartment building. The ground floor of the building consisted entirely of a private parking garage for tenants, and Duncan sometimes kept her vehicle in it.

The central dispute between the parties is whether Asset Recovery Specialists violated Wis. Stat. §425.206(2)(b) when they entered the garage shared by residents in Duncan's apartment building to repossess her vehicle. The court reviewed language within §425.206(2) which provides in full: In taking possession of collateral or leased goods, no merchant may do any of the following: (a) Commit a breach of the peace. (b) Enter *a dwelling used by the customer as a residence* except at the voluntary request of a customer. The court focused its review on the statutory language in italics.