Wisconsin Bankers
ASSOCIATION

Compliance Journal
December 2023

Special Focus

WDFI Division of Banking 2024 Escrow Rate – 0.18%

The Wisconsin Department of Financial Institutions (WDFI), Division of Banking, has calculated the interest rate required to be paid on required escrow accounts for residential mortgage loans subject to sec. 138.052(5), Stats., to be **0.18%** for 2024. The interest rate will be in effect **January 1, 2024** through **December 31, 2024**.

Pursuant to sec. 138.052(5)(am), Stats., except as provided in sec. 138.052(5)(am)(b), Stats., and unless the escrow funds are held by a third-party in a noninterest-bearing account, financial institutions which originate a loan on or after January 1, 1994, and before April 18, 2018, and which requires an escrow account must pay interest on the outstanding principal balance of the escrow at the rate established by WDFI's Division of Banking. Section 138.052 applies to loans secured by a first lien or first lien equivalent in a 1-4 family dwelling that is used as the borrower's principal residence.

WDFI's 2024 Escrow Rate Notice: https://dfi.wi.gov/Pages/FinancialInstitutions/BankingSavingsInstitutions/EscrowNotice.aspx

BOI Reporting Deadline Extended for Reporting Companies Credited or Registered in 2024

The Financial Crimes Enforcement Network (FinCEN) issued a final rule to amend its beneficial ownership information (BOI) reporting rule to extend the filing deadline for certain BOI reports. Under the reporting rule prior to the amendment, entities created or registered on or after the rule's effective date of January 1, 2024, had to file initial BOI reports with FinCEN within 30 calendar days of notice of their creation or registration. The amendment extends that filing deadline from 30 calendar days to 90 calendar days for entities created or registered on or after January 1, 2024, and before January 1, 2025, to give those entities additional time to understand the new reporting obligation and collect the necessary information to complete their filings. Entities created or registered on or after January 1, 2025, will continue to have 30 calendar days to file their BOI reports with FinCEN.

FAQs About BOI Reporting by Reporting Companies Versus by Banks

The following is a list of questions and answers regarding FinCEN's Beneficial Ownership Information Reporting Rule for reporting companies versus the requirements of banks under separate Bank Secrecy Act rules.

Q: Is a bank required to continue its procedures to collect beneficial owner information from its legal entity customers after January 1, 2024, when reporting companies begin to report beneficial ownership information (BOI) directly to FinCEN?

A: Yes. Currently there are separate rules under law, (a) FinCEN's Beneficial Ownership Information Reporting Rule for reporting companies and (b) FinCEN's Customer Due Diligence Rule and Beneficial Ownership for Legal Entity Customer Rule which are applicable to banks.

Despite reporting companies filing BOI with FinCEN, banks must still identify and verify the identity of any individual who owns 25% or more of a legal entity, and an individual who controls the legal entity. Banks are also required to continue their risk assessment and ongoing oversight efforts under their customer due diligence policy and procedures.

FinCEN has the authority to combine the BOI rules in the future which WBA expects will occur within the next several years.

Q: Is the information reported by a reporting company the same as what a bank collects under its beneficial owner rule?

A: No, the rules are not identical. A reporting company is to report information about their beneficial owners and company applicants. A beneficial owner is an individual who owns or controls at least 25% of a company or has substantial control over the company. A company applicant is an individual who directly files or is primarily responsible for the filing of the document that creates or registers the company. A reporting company may also use a FinCEN identifier of an individual or entity.

Under the rules applicable to banks, banks are required to identify and verify the identity of any individual who owns 25% or more of a legal entity, and an individual who controls the legal entity. The information is collected from the legal entity customer and verified via documentation or nondocumentary methods. There is no filing of the collected information with FinCEN and there is not a FinCEN identifier option.

Q: Is a bank required to question its business customer whether it has reported BOI to FinCEN? Or is a bank required to somehow verify that BOI was reported to FinCEN?

A: No. A bank is not required to question or confirm a reporting company's BOI filing with FinCEN. The reporting responsibility is solely with the reporting company. In addition, the electronic filing system used by FinCEN is not a public system. Banks do not have access to the filing system; therefore, there is no separate method for a bank to verify whether a reporting company filed or what was filed.

Q: Is a bank required to first ensure a business customer has reported BOI to FinCEN before establishing a deposit account or loan with the business?

A: No. Similar to the FAQ above, a bank is not required to first ensure a business customer has reported BOI to FinCEN before the bank can establish an account or loan with the business. The reporting responsibility is solely with the reporting company. The electronic filing system used by FinCEN is not a public system. Banks do not have access to the filing system; therefore, there is no separate method for a bank to verify whether a reporting company filed or what was filed.

Q: Are all entities required to file with FinCEN?

A: No. There are twenty-three specific types of entities that are exempt from the reporting requirements of the rule.

Q: Should the bank determine for its business customers whether the customer is exempt from the BOI reporting rule?

A: No. Business customers need make their own determinations of whether they are exempt. This is to help prevent a customer from claiming the bank made a wrong determination regarding an exemption. FinCEN's Small Entity Compliance Guide has a helpful chapter which includes questions the customer can answer to help them determine whether they are exempt.

Q: Is it the bank's responsibility to educate its business customers about the BOI reporting rule?

December 2023
Volume 29, Number 7

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A: No. It is not the bank's responsibility. Certainly, if banks receive questions from business customers about the rule the customer should be referred directly to FinCEN.

Q: Where should business customers be referred to for more information about the BOI reporting rule?

A: FinCEN has a dedicated webpage for its Beneficial Ownership Information Reporting Rule. The website includes a compliance guide, checklists, and informational videos about the rule. The website is also where reporting companies will file their required data starting in January 2024: https://www.fincen.gov/boi

2024 Adjusted State and Federal Regulatory Thresholds and Limits

As we approach the new year, below is a listing of several thresholds which have been adjusted by both state and federal regulators that go into effect in January 2024. Not all annually adjusted thresholds were released as of the time this publication went into creation mid-December. WBA will include an updated listing in the January 2024 *WBA Compliance Journal* with thresholds published after release of this edition. Below is a collection of thresholds effective **January 1, 2024**, including a link to pull each publication for reference.

Regulation Z, TILA

- The exemption threshold for Regulation Z (Truth in Lending Act) will increase to **$69,500**, up from $66,400. https://www.govinfo.gov/content/pkg/FR-2023-11-29/pdf/2023-25048.pdf

- The exemption threshold under Regulation Z for HPML appraisals will increase to **$32,400**, up from $31,000. https://www.govinfo.gov/content/pkg/FR-2023-11-29/pdf/2023-25047.pdf

- The dollar amount thresholds under Regulation Z for HOEPA and QM-related loans have been adjusted as follows:
    - For HOEPA loans, the adjusted total loan amount threshold for high-cost mortgages will be **$26,092**.
    - The adjusted points-and-fees dollar trigger for high-cost mortgages will be **$1,305**.
    - For QMs under the General QM loan definition in § 1026.43(e)(2), the thresholds for the spread between the annual percentage rate (APR) and the average prime offer rate (APOR) will be:
        - 2.25 or more percentage points for a first-lien covered transaction with a loan amount greater than or equal to **$130,461**;
        - 3.5 or more percentage points for a first-lien covered transaction with a loan amount greater than or equal to **$78,277** but less than **$130,461**;
        - 6.5 or more percentage points for a first-lien covered transaction with a loan amount less than **$78,277**;
        - 6.5 or more percentage points for a first-lien covered transaction secured by a manufactured home with a loan amount less than **$130,461**;
        - 3.5 or more percentage points for a subordinate-lien covered transaction with a loan amount greater than or equal to **$78,277**; or
        - 6.5 or more percentage points for a subordinate-lien covered transaction with a loan amount less than **$78,277**.
    - For all categories of QMs, the thresholds for total points and fees will be:
        - 3 percent of the total loan amount for a loan greater than or equal to **$130,461**;
        - $3,914 for a loan amount greater than or equal to **$78,277** but less than **$130,461**;
        - 5 percent of the total loan amount for a loan greater than or equal to **$26,092** but less than **$78,277**;
        - **$1,305** for a loan amount greater than or equal to **$16,308** but less than **$26,092**; and
        - 8 percent of the total loan amount for a loan amount less than **$16,308**.

- For open-end consumer credit plans under TILA, the threshold that triggers requirements to disclose minimum interest charges will remain unchanged at **$1.00**. https://www.govinfo.gov/content/pkg/FR-2023-09-21/pdf/2023-20476.pdf

Other Regulatory Thresholds and Limits

- The dollar amount of the maximum allowable charge for disclosures by a consumer reporting agency to a consumer pursuant to Fair Credit Report Act (FCRA) section 609 for the 2024 calendar year is **$15.50**. https://www.govinfo.gov/content/pkg/FR-2023-11-15/pdf/2023-25172.pdf
- The exemption threshold for Regulation M (Consumer Leasing Act) will increase to **$69,500**, up from $66,400. https://www.govinfo.gov/content/pkg/FR-2023-11-29/pdf/2023-25049.pdf
- The FDIC Designated Reserve Ratio remains **2 percent** for 2024. https://www.govinfo.gov/content/pkg/FR-2023-11-22/pdf/2023-25814.pdf
- The OCC is maintaining the general assessment, independent trust, and independent credit card fee schedules from 2023. There will be no inflation adjustment to assessment rates. OCC is increasing the hourly fee for special examinations and investigations to **$170** from $161. The increase is to ensure adequacy in recovering the cost of conducting special examinations and investigations. https://www.occ.treas.gov/topics/supervision-and-examination/examinations/assessments-and-fees/notice-of-fees-semiannual-assessment.html
- Contribution limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is increased to **$23,000**, up from $22,500. The limit on annual contributions to an IRA increased to **$7,000**, up from $6,500. www.irs.gov/newsroom/401k-limit-increases-to-22500-for-2023-ira-limit-rises-to-6500
- Multifamily loan purchase caps for Fannie Mae and Freddie Mac will be **$70 billion** for each enterprise, for a combined total of $140 billion. The caps reflect current market forecasts. FHFA will continue to require that at least 50 percent of Fannie's and Freddie's multifamily business be mission-driven affordable housing. https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/2024-Multifamily-Caps-Fact-Sheet.pdf
- The conforming loan limit values for mortgages to be acquired by Fannie Mae and Freddie Mac in 2024 for one-unit properties will be **$766,550** an increase from $726,200. https://www.fhfa.gov//Media/PublicAffairs/Pages/FHFA-Announces-Conforming-Loan-Limit-Values-for-2024.aspx
- New loan limits for FHA's Single Family Title II Forward and Home Equity Conversion Mortgage (HECM) insurance programs, based upon property size and location, range from **$498,257** to **$3,317,400**. https://www.hud.gov/press/press_releases_media_advisories/hud_no_23_265

Regulatory Spotlight

Agencies Release 2024 Exemption Thresholds for HPML Appraisals, Regulations M and Z.

The Bureau of Consumer Financial Protection (CFPB), Board of Governors of the Federal Reserve System (FRB), and Office of the Comptroller of the Currency (OCC) issued a final rule to amend the official interpretations for their regulations that implement section 129H of the Truth in Lending Act (TILA). Section 129H of TILA establishes special appraisal requirements for higher-risk mortgages, termed higher-priced mortgage loans (HPMLs) in the agencies' regulations. OCC, FRB, FDIC, Federal Housing Finance Agency (FHFA), and National Credit Union Administration (NCUA) (collectively, the agencies) jointly issued final rules implementing this requirement, effective **01/18/2014**. The agencies' rules exempted, among other loan types, transactions of $25,000 or less, and required that the loan amount be adjusted annually based on any annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). If

Wisconsin Bankers Association

Compliance Journal

November 2023

Special Focus

Recent Fraud Trends as Reported by WBA Financial Crimes Committee

Data released by the Federal Trade Commission earlier this year shows that consumers reported losing nearly $8.8 billion to fraud in 2022, an increase of more than 30 percent over the previous year. Those are sobering numbers, and WBA's Financial Crimes Committee would be quick to point out that figure only includes fraud that was reported.

The WBA Financial Crimes Committee is comprised of fraud officers, risk managers, and security specialists. The Committee serves to inform and educate the Wisconsin banking industry, law enforcement, and the general public on the changing security and criminal threats to the financial sector and develops solutions to those threats. In that role, the group has put together this article to report on the most common fraud trends seen in Wisconsin.

While this article will discuss three of the most common fraud schemes shared by the Committee, the group also shared that there are some general fraud trends to be aware of as well. Primarily, fraudsters are becoming increasingly adaptive in their behavior. As technology, methods of business, and commerce continue to develop, fraudsters are continually developing their methods to become more and more convincing. In this way, the group stresses the importance of monitoring those tactics through the tools available such as through Financial Crimes Enforcement Network (FinCEN) alerts, news sources, and information sharing.

Felony Lane Gang

The "felony lane gang" is a term used to refer to a group of organized criminals and gets its name from their methods. While this group is not new, they have been active again in Wisconsin recently. The group travels across the country and recruits individuals for smash-and-grab petty thefts which are then developed into larger schemes. They will steal cash, checks, and personal identifying cards such as driver's licenses, credit cards, and debit cards. They then impersonate those individuals to conduct fraudulent transactions. This group gets their name from their common strategy of targeting banks through use of the far drive-up lane to make positive identification more difficult.

This scheme can often be difficult for both law enforcement and banks to identify. The actors will typically use late model vehicles, often rented, with stolen Wisconsin license plates. They will dress the part, often wearing wigs and costumes to resemble the individual whose identity they have stolen. Being aware of typical security questions, they will have two forms of identification available. Individuals may often appear anxious or rushed if confronted, or if the individual cannot accurately answer security questions. They also typically only visit branch locations out of the area of the customer's address or typical activity to avoid being spotted. Also look out for their second form of identification, which may have been previously closed or hot-carded (e.g., a debit or credit card previously issued).

The Committee recommends encouraging customers to report loss of access devices, account information, or other identifying information. Then, a system notification or warning to a relationship profile can be added to flag any potential felony lane gang activity. Staff should be encouraged to compare the likeness of the person conducting the transaction to the identification presented. Often, the actors will wear covering garments, such as sunglasses, hats, cowls, and coats to make this more difficult. Depending on branch locations and overall risk tolerance, a bank might also consider establishing additional identification procedures, perhaps for transactions that exceed a certain dollar amount. WBA's Financial Crimes Committee has reported that while it's most common to see actors use drive-up lanes to commit fraud, they have been known to enter a branch lobby as well. The Committee encourages banks to follow their procedures on suspicious transaction activity to minimize losses.

Tech Scams

Tech scams refer to a specific type of imposter scams. While not new, imposter scams continue to be a one of the most frequent types of fraud the Committee sees occurring. These can be romance, military, or family for example, where an imposter talks a customer into feeling sorry for them and sending them money. Tech scams have recently become one of the most frequent types of imposter scams, being a type of fraud perpetrated through phone, email, and text messages. Fraudsters pose as tech support representatives, government agencies, international organizations, or charities. The fraud is conducted through pop-up scams and phishing. While scammers frequently target businesses, they target individual consumers as well.

The most basic scheme involves a scammer who contacts their target under the false pretense of representing a legitimate organization. Once this contact is made, and the target is convinced, the scammer has many options. They can simply coerce the target into providing funds, but will often gather information in order to take the scam further. Recently, the Committee has seen this tactic deployed through the use of fictitious pop-up messages, appearing to originate from a bank or other financial institution, or software or technology company, such as Microsoft. The messages appear on a computer screen or login page and warn of a security issue, or unusual account activity or access. It provides a contact method to receive help, through which scammers will ask for payment or information.

For example, a customer might search for the bank's website and click on a phishing link inside a pop-up message that instructs them to call a phone number to resolve a security issue with their bank account. If the customer calls that number, a fraudster will pose as a bank fraud representative, and request the customer's credentials to gain access to their computer or account to resolve the issue. After gaining access, the fraudsters will initiate unauthorized transactions.

The Committee reports that the worst cases often result in wire fraud. The scammer uses the methods above to get access to a business customer's email account, sends an email to their wire approval team, and fraudulently charges the account. A recent case shared by the Committee involved fraudulent transactions amounting to over $600,000.

The Committee members all agree that one of the best ways to protect against tech scams is financial literacy. For example, combatting wire fraud can be done by ensuring that business customers understand and follow all details or set up templates for wires. Both business and consumer customers alike should be educated to understand that banks will never ask for account information, and know how to spot these types of scams to prevent them from occurring is the best defense. Customers should also be encouraged to notify the bank as soon as possible if they believe they have fallen victim to a scam.

ATM Skimmers

Criminals continue to target automated teller machines (ATMs) using skimmers, devices which attach to the machines to record keystrokes, capture PINs, and credit or debit card account numbers. In addition to ATMs, criminals have been known to add similar devices to credit or debit card readers at checkout registers, especially at gas stations, convenience stores, or other merchants. Lately, criminals have begun utilizing devices that can even capture data from Europay, Mastercard, and Visa (EMV) chips.

These devices are deployed in various forms, such as card-reader overlays. Such devices are made of plastic and fit over the card slot. When a card is inserted, the device reads

November 2023
Volume 29, Number 6

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the data and stores it. These readers can be spotted by looking for signs of tampering or alteration with the machine, such as scratch marks, damage, or adhesives.

Criminals may also use hidden cameras. Mini-cameras might be placed near the screen, keypad, or in other areas such as a brochure holder. Customers should be advised to keep an eye out for tiny holes in the ATM's housing or something else that might look like it has been stuck near the cover.

Criminals have been known to attach dummy keypads over an ATM's real keypad to record and capture PIN numbers as they are entered. The keypad might be fake if it looks too thick or otherwise irregular. Some thieves go as far as placing a fake ATM cover that could contain card-reader overlays, hidden cameras, and PIN-capture overlays over some or all of a real, fully operating machine. The best way to detect such alterations is to look for flaws like loose wires, seams that are not flush, and slots or keypads that look out of place.

Customers should be advised to avoid using an ATM or a credit or debit card reader if anything looks suspicious, such as loose or extra parts, and encouraged to notify the bank, law enforcement, or owner of the machine immediately. They should avoid ATMs in remote places, especially if the area is not well lit or not visible to security cameras and the general public. A good tip to avoid hidden cameras is to shield the keypad when entering a PIN at the ATM or a retailer's checkout area. And, of course, customers should be encouraged to regularly check their bank and credit card accounts for unauthorized transactions, no matter how small.

WBA would like to thank the Financial Crimes Committee for sharing the information within this article.

Treasury Creates New Procedures for Payment of Treasury Checks

On November 1, 2023, the Treasury Department's Bureau of Fiscal Service (Fiscal Service) issued a final rule which amends the regulations that govern the payment of checks drawn on the United States Treasury (Treasury Checks), 31 CFR Part 240. The amendments coincide with the development of Fiscal Service's enhanced check post payment processing system, which will provide Treasury Check return information to financial institutions through existing communication channels with the Federal Reserve Banks (FRBs), generally prior to the expiration of the time periods in which financial institutions must make Treasury Check deposits available for withdrawal as prescribed by Regulation CC, Availability of Funds and Collection of Checks.

The following is information about the changes and steps to consider. Unfortunately, Treasury did not give much advance notice of the change as the final rule is effective **December 1, 2023**.

Background

Overall, the final rule is intended to reduce the number of Treasury Checks being processed despite Fiscal Service placing a stop payment on the check.

Currently, when either Fiscal Service or a payment certifying agency puts a "stop payment" (also known as a "check stop") on a Treasury Check to cancel it, there is a possibility that the canceled check may still be paid. Fiscal Service or an agency may put a "stop payment" on a check payment because the payee submitted a check claim (*i.e.*, claimed that the check was either lost or stolen), because the certifying agency realized the payment was incorrect, or because it was otherwise improper.

When a canceled or "stopped" check is subsequently paid, this leads to what Fiscal Service refers to as a payment over cancellation (POC). POCs are improper payments. As mentioned above, Fiscal Service has developed enhancements to its post payment processing system that will result in Treasury Check return information being made available to financial institutions sooner than is the case today. Through the system enhancements, Fiscal Service is to provide check return information to financial institutions through existing channels within the time periods prescribed by Regulation CC, Availability of Funds and Collection of Checks (12 CFR part 229), for when a financial institution must make funds deposited by Treasury Check available for withdrawal.

Revised and New Definitions to Part 240

To implement the change in procedure, Fiscal Service revised the definition of “reasonable efforts” within part 240 and added several new definitions, including “validity” or “valid check,” and “stop payment.”

The definition of reasonable efforts is important as the steps within the definition are actions financial institutions need take to avoid liability for a POC.

Under the current regulation, a financial institution generally is not liable for a POC if the institution has taken “reasonable efforts” to ensure the check is authentic. The definition has been revised to include a requirement that financial institutions wait for check return information within the time periods set out by Regulation CC to help verify that a Treasury Check is valid and authentic.

More specifically, under the final rule, “reasonable effort” means, at a minimum:

1. Confirming the validity of a check by obtaining the check return information prior to making the funds from the check available for withdrawal (except when the check return information has not been provided within the applicable timeframe prescribed by Regulation CC, and making funds available for withdrawal is necessary to comply with Regulation CC; however, this exception does not apply if the presenting bank is otherwise subject to liability due to the presentment guarantees found in §240.4); and

2. Confirming the authenticity of the check such as by verifying the existence of the Treasury watermark on an original check.

Acceptance of a check by electronic image or other non-physical means does not impact reasonable efforts requirements. Based upon the facts at hand, including whether a check is an original check, a substitute check, or an electronic check, reasonable efforts may require the verification of other security features.

Where a financial institution has taken reasonable efforts but check return information for a POC on a properly presented check is not transmitted to the financial institution prior to the funds availability timeframe specified in Regulation CC, the financial institution would not be liable for releasing the funds associated with the Treasury Check.

As indicated in item 1. above, financial institutions need remember that the presentment guarantees under section 240.4 of the regulation is a separate component from the revisions made to the reasonable efforts definition. Part 240.4 is an existing requirement under the Fiscal Service regulation. Compliance with funds availability under Regulation CC and the protections under the final rule regarding compliance with Regulation CC does not affect the presentment guarantees of the regulation. As is currently the case, if Fiscal Service declines a check due to improper presentment and reverses the provisional credit, the presenting financial institution may still be liable for payment on the check if a presentment guarantee has not been met. More information regarding part 240.4 is provided below.

The final rule also made conforming changes to the regulation to require that financial institutions ensure a Treasury Check has not been canceled before making the funds associated with that check available for withdrawal.

Use of Fiscal Service’s Treasury Check Verification System (TCVS)

In addition to receiving check return information through existing FRB channels, a financial institution may choose to obtain early notice regarding the validity and authenticity of Treasury Checks by using the Fiscal Service’s Treasury Check Verification System (TCVS). While the final rule does not require financial institutions to use TCVS, the use of TCVS may allow financial institutions to catch canceled, duplicate, or other problematic checks at the time of presentment, as opposed to after presentment but before the financial institution makes deposited funds available for withdrawal. The TCVS, in conjunction with the enhanced post payment system, is intended to help financial institutions avoid accepting duplicate presentations, thus avoiding the associated liability. The TCVS will similarly be of assistance to financial institutions in identifying Treasury Checks where the payment amount has been altered, as well as for counterfeit instruments purporting to be Treasury Checks.

Presentment Guarantees, 31 Part 240.4

Part 240.4 currently includes presentment guarantees which are made by the guarantor of a Treasury Check presented to Fiscal Service for payment. Under the rule, the "guarantor" is defined as a financial institution that presents a check for payment and any prior indorser(s) of a check.

Under part 240.4, the guarantors of a Treasury Check presented to Fiscal Service for payment are deemed to guarantee that all prior indorsements are genuine, whether or not an express guarantee is placed on the check, that the check has not been materially altered, that the guarantors have no knowledge that the signature of the drawer is forged or unauthorized, and that the guarantors have made all reasonable efforts to ensure that the check is an authentic Treasury Check, not a counterfeit check.

The final rule has revised paragraph (d) within part 240.4 to state that the guarantors have made all reasonable efforts to ensure that a check is both an authentic Treasury Check (*i.e.*, it is not a counterfeit check) and a valid Treasury Check (*i.e.*, it has not been previously negotiated or canceled).

Impact on the Final Rule

As a result of the final rule, financial institutions should consider current check cashing procedures involving Treasury Checks. At a minimum, financial institutions need be aware of the potential risk to the institution should it release funds related to the negotiation of a Treasury Check before information may be shared by Fiscal Service with the financial institution regarding the check.

Under the final rule, Fiscal Services is to make check return information available through existing FRB changes in time for the financial institution to meet its funds availability requirements for Treasury Checks under Regulation CC. Pursuant to Regulation CC section 229.10(c)(i), a check drawn on the Treasury of the United States and deposited in an account held by the payee of the check receives next day availability. Thus, Fiscal Service would be required to share information regarding a Treasury Check deposited into the payee's account before funds must be made available the day after deposit.

Some financial institutions in Wisconsin allow same day availability such that if a Treasury Check were presented for cash, the institution is willing to negotiate the check for cash rather than accept it for deposit into the payee's account and make the funds available next day. In such circumstance, the financial institution may not escape liability for a POC as it would have made funds available before the institution received check return information regarding the Treasury Check from Fiscal Service through the existing FRB communication channels. Perhaps the financial institution is willing to accept such risk as it knows its customers who seek to cash a Treasury Check and the institution believes the chances of such items being determined POC is limited, but it is a risk the institution should at least consider. Perhaps in such circumstances the institution will consider the use of the TCVS before cashing the Treasury Check. Perhaps the payee can be encouraged to instead have their Treasury Checks directly deposited into the payee's account rather than negotiate paper checks.

Financial institutions may also want to reach out to those business customers who cash Treasury Checks at their separate establishments, such as at local grocery stores, bars, and others who cash checks to make the business customers aware of the risks they are taking regarding check cashing. When those business customers then deposit previously negotiated Treasury Checks as part of their own check deposit, if the financial institution were then to receive notice from the Fiscal Service that a negotiated Treasury Check were a POC, the financial institution would look to reclaim any such loss from the business customers when possible.

Summary

Effective December 1, 2023, Fiscal Service will bear the responsibility to provide Treasury Check return information to financial institutions through existing communication channels with the FRBs, generally prior to the expiration of the time periods in which financial institutions must make Treasury Check deposits available for withdrawal as prescribed by Regulation CC.

Special Focus

Under the final rule, financial institutions in negotiating Treasury Checks will be liable if it pays a POC without waiting to receive the return information that would enable the financial institution to know the check has been canceled. Separately, institutions remain responsible for presentment warranties involving Treasury Checks. The final rule may be viewed at: www.govinfo.gov/content/pkg/FR-2023-11-01/pdf/2023-24039.pdf.

Regulatory Spotlight

Agencies Publish Statement on Noncitizen Borrowers Under ECOA.

The Bureau of Consumer Financial Protection (CFPB) and the Department of Justice (DOJ) (collectively, the agencies) released a joint statement on fair lending and credit opportunities for noncitizen borrowers under the Equal Credit Opportunity Act (ECOA). ECOA does not expressly prohibit consideration of immigration status, and as explained further in the statement, a creditor may consider an applicant's immigration status when necessary to ascertain the creditor's rights regarding repayment. However, the agencies state that creditors should be aware that unnecessary or overbroad reliance on immigration status in the credit decisioning process, including when that reliance is based on bias, may run afoul of ECOA's antidiscrimination provisions, and could also violate other laws. The joint statement may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-10-18/pdf/2023-22968.pdf. *Federal Register*, Vol. 88, No. 200, 10/18/2023, 71845-71847.

Agencies Issue Final Guidance on Climate-Related Financial Risk Management for Large Financial Institutions.

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) jointly issued principles providing a high-level framework for the safe and sound management of exposures to climate-related financial risks (principles). The principles are intended for the largest financial institutions, those with over $100 billion in total consolidated assets. The principles are intended to support efforts by large financial institutions to focus on key aspects of climate-related financial risk management. The guidance may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-10-30/pdf/2023-23844.pdf. *Federal Register*, Vol. 88, No. 208, 10/30/2023, 74183-74189.

Agencies Extend Comment Period for Proposed Revised Capital Rule for Large Banking Organizations.

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC), (collective, the agencies) have extended the comment period for the proposed rule which would revise the capital rule for large banking organizations. On **09/18/2023**, the agencies published in the *Federal Register* a proposal to substantially revise the capital requirements applicable to large banking organizations and to banking organizations with significant trading activity. The agencies have determined that an extension of the comment period until **01/16/2024**, is appropriate. The proposed rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-10-27/pdf/2023-23671.pdf. *Federal Register*, Vol. 88, No. 207, 10/27/2023, 73770-73772.

CFPB Publishes Advisory Opinion Regarding Consumer Information Requests to Large Banks and Credit Unions.

The Bureau of Consumer Financial Protection (CFPB) published an advisory opinion regarding section 1034(c) of the Consumer Financial Protection Act, which requires large banks and credit unions to comply in a timely manner with consumer requests for information concerning their accounts for consumer financial products and services, subject to limited exceptions. Section 1034(c) applies to insured depository institutions and credit unions that offer or provide consumer financial products or services and that have total assets of more than $10 billion, as well as their affiliates. The advisory opinion is applicable as of **10/16/2023**. The advisory opinion may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-10-16/pdf/2023-22774.pdf. *Federal Register*, Vol. 88, No. 198, 10/16/2023, 71279-71283.

Wisconsin Bankers ASSOCIATION

Compliance Journal
October 2023

Special Focus

New FinCEN Resources for BOI Reporting Rule as 2024 Approaches

As the new year is just a few short months away, the Financial Crimes Enforcement Network (FinCEN) has released helpful new resources regarding its beneficial ownership information (BOI) reporting rule to assist reporting companies with understanding their filing requirements.

As bankers may be fielding questions regarding the rule from business customers, the following is a short summary of the reporting rule and a link to the new resources. The rule applies to domestic and foreign companies that do not qualify for an exemption from the rule.

Filing Begins January 1, 2024

Under the FinCEN BOI reporting rule, a reporting company need report specific information about the company, its beneficial owners, and in some circumstances its company applicants—the individual who filed the documentation to create the reporting company or was primarily responsible for directing or controlling the filing of the creation or registration documentation.

Any domestic or foreign reporting company created on or after **01/01/2024**, must file an initial 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 reporting company has been created. In Wisconsin, the applicable office would be the Department of Financial Institutions (WDFI).

Any domestic reporting company created before **01/01/2024**, and any entity that became a foreign reporting company before **01/01/2024**, will have until **01/01/2025**, to file their initial BOI report with FinCEN.

On **09/28/2023**, FinCEN proposed to amend the BOI reporting rule to extend the 30-calendar day filing deadline to ninety (90) days for reporting companies created on or after **01/01/2024** and before **01/01/2025**, to give such entities additional time to understand the new reporting obligations and collect the necessary information to complete the filings. Entities created or registered on or after **01/01/2025**, would have 30 days to file their BOI reports with FinCEN, as required under the reporting rule. Comments regarding the proposed amendment are due **10/30/2023**. FinCEN will publish a final rule if the proposal is adopted.

FinCEN's portal for filing BOI reports will not be in effect until **01/01/2024**.

Updated and Corrected Reports

In addition to an initial report, a reporting company may need to file an updated or corrected BOI 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 within 30 calendar days after the date on which such change occurs.

Activities such as the following would require a reporting company to file an updated report:

- 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.

If any filed report was inaccurate when filed and remains inaccurate, the reporting company must 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 the reporting rules if filed within 90 calendar days after the date on which the inaccurate report was filed.

FinCEN Resources

To assist reporting companies with their filings, FinCEN has released a *Small Entity Compliance Guide* in which there is detailed information to help answer questions such as: (a) does my company have to report its beneficial owners; (b) who is a beneficial owner of my company; (c) does my company have to report its company applicants; (d) what specific information does my company need report; (e) when and how should my company file its initial BOI report; and (f) what if there are changes to or inaccuracies in reporting information.

To answer the questions posed, FinCEN has provided prompts for the reporting company to consider so the company can better identify who and what to report. The guide also provides an Appendix with a detailed regulation reference page for each aspect of reportable data.

FinCEN has also created a series of frequently asked questions (FAQs) which are in response to inquiries received related to the rule. The FAQs include answers related to general topics, the reporting process, and about what companies are required to report BOI information to FinCEN.

October 2023
Volume 29, Number 5

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Quick reference materials are also available. Several of the quick references are available in Spanish, Chinese Simplified, and Chinese Traditional. FinCEN has also created two videos regarding the rule.

The new resources are easily found on FinCEN's BOI Reporting website. A link to the final BOI reporting rule, the proposal to modify the initial filing period, and other regulatory actions related to the rule may also be found at the same website under the "reference materials" section.

FinCEN BOI Reporting Rule website: https://www.fincen.gov/boi

Year-end Frequently Asked Escrow Questions

Banks throughout Wisconsin are preparing to issue checks as many pay taxes from escrow by December 20th every year. As such, questions often arise as to state and federal requirements regarding escrow accounts. This article presents several questions and answers to refresh banks on relevant requirements, and important considerations regarding escrow accounts.

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

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

For covered loans, this section requires banks to provide an escrow notice before closing giving the borrower options regarding how the bank will make payments from the amount escrowed. The required options are:

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

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

Regardless of whether a notice under state law is required, banks are reminded that a voluntary agreement is still required under the Real Estate Settlement Procedures Act (RESPA) to pay property taxes annually as permitted under Wis. Stat. section 138.052(5m). See the discussion below regarding the interconnection between state and federal law.

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

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

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

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

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

A3: RESPA preempts state law only to the extent of any inconsistency. Generally, escrows governed by section 138.052(5m) must also comply with RESPA, which means banks must be aware of both requirements and the nuances of how they interact. This means banks must disburse tax escrows in installments, or as otherwise agreed to by the borrower, as required by RESPA. It also means that banks must provide some form of tax escrow option form, as required by section 138.052(5m). It is helpful to keep in mind that the installment requirement is a RESPA component, not a Wisconsin component. Thus, nuances arise because RESPA requires taxes to be disbursed in installments, but Wisconsin offers more flexibility.

For example, Wisconsin permits taxes to be paid annually. RESPA, however, requires taxes to be disbursed in installments. This apparent contradiction is rectified by the fact that RESPA does allow the borrower to voluntarily, in writing, permit an annual disbursement. Thus, banks must confirm which tax escrow option under Wisconsin law their borrower has elected to use. If they have elected for an annual disbursement (for example, under the pay by December 20 method), RESPA requires voluntary agreement. This may seem implied, but it is not always the case. It depends upon how the bank's escrow agreement and option election form has been drafted and completed by the borrower. The important distinction is that the election has clearly been made voluntarily and this can be proved to an examiner.

FIPCO's WBA Tax Escrow Option Election form meets the requirements under Wis. Stat. 138.052(5m) and also serves as the voluntary agreement to disburse property taxes out of escrow in any method other than installments to comply with RESPA.

Q4: What if a deficiency occurs before disbursement?

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

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

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

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

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

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

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

A5: As a lingering effect of the pandemic or other economic impact, banks may have borrowers who had deferred or forborne payments. Bank should consider its deferral and forbearance agreements to confirm whether the deferral or forbearance included escrow payments. Even if it did not, financial distress caused by the prolonged effect of the pandemic or by other economic conditions on some borrowers may have resulted in escrow shortages and deficiencies. Banks should consider how to monitor loans for payments, and accounting for expected, and unexpected shortages. Specific attention may need to be paid to escrow balances for loans in deferral, forbearance, or modification. Banks should identify loans that will be short, and determine how the deficiency will be handled, with the above considerations in mind.

Q6: What is the escrow rate for 2023, as set by 138.052?

A6: The Wisconsin Department of Financial Institutions (WDFI), Division of Banking, has calculated the interest rate required to be paid on escrow accounts for residential mortgage loans subject to Wisconsin Statute Section 138.052(5) to be **0.11%** for 2023. The interest rate shall remain in effect through December 31, 2023.

WBA will notify the membership of the rate for 2024 when it is issued by WDFI.

Q7: Does 138.052 require Wisconsin banks to pay interest on escrow accounts?

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

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

Q8: Bank is closing loan in December for which bank will require escrow for the payment of taxes. The first mortgage payment will be in February. Can bank escrow for 2023 taxes to be paid in 2024?

A8. No. RESPA's escrow collection rules are prospective in nature. Bank should only collect for 2024 taxes to be paid either in December 2024 in a lump sum (with borrower's permission as outlined above) or in installments. Bank should not collect for anything between December 1 and 31st because nothing is owing during that time as the bank should only be collecting for 2024 taxes. Bank should not be collecting for 2023 taxes for payment in 2024. Borrower should be on his/her own to pay 2023 taxes.

Wisconsin Bankers ASSOCIATION

Compliance Journal

September 2023

Special Focus

Who Need Sign the Mortgage?

A frequently asked question to the WBA Legal Call Program remains, "who need sign the real estate mortgage." The answer is not always straightforward as a number of factors need be taken into consideration. Lenders often look to rely on the standard principle—only those parties on the deed to the property securing the loan are required to sign the mortgage. However, lenders also need consider any interests of married Wisconsin residents given that Wisconsin is a community property state and has a Marital Property Act which provides homestead protections to spouses.

This article is meant to answer the question of who need sign the real estate mortgage, highlight a 2017 Wisconsin court case which confirmed that, consistent with Wisconsin statutes, both spouses must sign a mortgage if it conveys any interest in the homestead of either spouse or both spouses, provide instruction for completing the WBA 428 real estate mortgage, and provide several examples to illustrate various interests.

Wisconsin Statute Provisions

Wisconsin statute section 706.02 provides the formal requisites for conveyances of real property. For transactions by which any interest in land is created, aliened, mortgaged, assigned, or otherwise affected in law or in equity, such interests are not valid unless the interest is evidenced by a conveyance that satisfies all of the requirements listed within the statute section.

One of the requirements critical to the question of who is to sign the mortgage is found within section 706.02(1)(f) which requires the conveyance to be signed by each spouse if the conveyance alienates any interest of a married person in the homestead. An exception to this requirement is for a purchase money mortgage; on a purchase money mortgage pledging that property as security, only the purchaser need sign the mortgage.

"Homestead" is defined under Wis. Stats. sec. 706.01(7) as "the dwelling, and so much of the land surrounding it as is reasonably necessary for use of the dwelling as a home, but not less than one-fourth acre, if available, and not exceeding 40 acres." Customers need inform the lender whether the property is homestead property, and such information is included on the mortgage itself.

As a result of the statutory language under 706.02(1)(f), unless the mortgage is a purchase money mortgage, if a married person is on deed to the property securing the loan, the spouse of that individual will also be required to sign the mortgage if the conveyance alienates either or both spouses' homestead interest, even if the spouse is not on the deed. The lender need require signatures of all titleholders and the spouse of married titleholder if the property is the homestead property of either or both spouses.

U.S. Bank National Association v. Charles E. Stehno III, 2017 WI App. 57 (August 30, 2017)

In 2017, a Wisconsin court case confirmed, consistent with Wisconsin statutes, that both spouses must sign a mortgage if it conveys an interest in the homestead of either spouse or both spouses. See *U.S. Bank National Association v. Charles E. Stehno III*, 2017 WI App. 57 (August 30, 2017).

In the Stehno case, the bank attempted to foreclose on mortgages signed by Charles Stehno in December 2002 and

April 2003. The property was Stehno's homestead at the time he signed the mortgages. However, the mortgages were not signed by his then-spouse, Candice Wells. Therefore, according to the court, the mortgages were invalid from the start against both spouses because only Stehno signed them.

WBA 428 Real Estate Mortgage Language and Completion

Upon determining who is to sign a mortgage, given the statutory provisions and a court case interpreting such provisions, lenders also need understand the language of the mortgage document used when taking a security interest in real property. When using WBA documents, the document which grants a security interest in real property is the WBA 428 Real Estate Mortgage (WBA 428).

The WBA 428 has long identified the "Mortgagor" as the party(s) who mortgages, conveys, assigns, grants a security in and warrants to the "Lender" in consideration to a sum of dollars loaned or to be loaned to the "Borrower," whether one or more.

As a result of the 2017 court case, many forms vendors revised real estate mortgages to more clearly delineate the homestead interest in mortgage properties, as well as those married and unmarried mortgagors. The additional language was meant to help lenders ensure the mortgage was signed by the appropriate parties. The WBA 428 and the WBA 428B Real Estate Mortgage (Business) were revised at that time for this purpose.

In particular, language was added above the Property Description (section 1) and three new sections were added to the WBA 428, listed as sections (a), (b), and (c) on page 1. A lender should complete sections (a), (b), and (c) on page 1, as applicable. Section (a) will identify all individuals with a homestead interest in the property (whether those persons are Mortgagors or not). Section (b) should list all of the married Mortgagors. Section (c) should list all of the unmarried Mortgagors. Examples for how to complete these sections of the WBA 428 may be found later in this article.

To answer the question who must sign the mortgage, everyone who is on the deed as an owner should sign the mortgage. In addition, everyone who has a homestead interest in the property being mortgaged should also sign the mortgage unless the mortgage is a purchase money mortgage, in which case only the purchaser is required to sign, regardless of homestead rules. With that in mind, here are the steps that should be taken when considering who is to sign the mortgage:

1. **Who is listed in the deed as owning the property?** If the lender is working with a title company, the title commitment should have this information. The best source is the warranty deed but the title commitment should also list who the record owners are. The record owner(s) are always the Mortgagor(s). But, should anyone else be the Mortgagor? The remaining questions help to identify any other individual who may be required to sign the mortgage.
2. **Is the transaction a purchase money mortgage?** If yes, then the remaining questions do not matter. If the answer is no, lenders would go on to the next questions. Unfortunately, ch. 706 does not define a "purchase money mortgage." Another Wisconsin statute, sec. 708.09 defines a "purchase money mortgage" to mean a mortgage given as part of the transaction of purchase of the property on which the mortgage is placed. If the mortgage is not a purchase money mortgage, lenders would answer the additional questions.
3. **Are the mortgagor(s) married?** If no, then lenders do not need the signature of any other person on the mortgage. If yes, lenders would go on to the next question.
4. **If the mortgagor(s) are married, will the property be the homestead of the married mortgagors?** If yes, then the spouse with the homestead interest also signs the mortgage.

September 2023
Volume 29, Number 4

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Examples to Illustrate WBA 428 Form Completion

Keeping the questions listed above in mind, the following examples help illustrate how to complete sections (a),(b), and (c) within the WBA 428 and to help answer the question who need sign the mortgage.

Example 1: Andrea Anderson and Alphonso Anderson, who are married to each other, are purchasing their new home. Both will be the new owners and will be listed on the deed. No other person will own the property. How is the mortgage completed?

Since this is their new home, they both have a homestead interest in the property. So, in section (a) Andrea Anderson and Alphonso Anderson are listed as having a homestead interest. In section (b) lenders would have Andrea Anderson and Alphonso Anderson identified as being married. Since no one else is signing the mortgage, the answer to (c) is None.

Both Andrea Anderson and Alphonso Anderson sign the mortgage as both are titleholders.

Example 2: Beatrice Bennett and Robert Bennett, who are married to each other, are refinancing their mortgage loan, which is secured by the home where they both live. Both are borrowers but only Beatrice Bennett is listed in the deed as owning the property. Section (a) would list both Beatrice Bennett and Robert Bennett as having a homestead interest because it is their home which is being mortgaged. Section (b) would be completed with Beatrice and Robert, and section (c) would be None because there are no other mortgagors on the property.

Both Beatrice Bennett and Robert Bennett sign the mortgage, pursuant to sec. 706.02(1)(f).

Example 3: Catrina Cardone and Carl Kane are unmarried, but they are both living in the house where she was raised and now owns. They are getting a loan from the lender and securing the loan with the home. Who has a homestead interest in the property?

Catrina has a homestead interest, and she is a record owner so she is a mortgagor. She is unmarried so her name would complete section (c). No one is married so section (b) would be completed with None. Section (a) would not include Carl's name because he is not married to Catrina.

Catrina signs the mortgage as she is titleholder of the property. If Catrina and Carl were married then he would have a homestead interest and he would also sign to mortgage his homestead interest.

Example 4: Diane Diamond and Desmond Diamond are married and will be living in a home that is owned by Diane's father and mother, Eric and Erin Edwards. Who are the mortgagors?

Eric and Erin Edwards, because they own the property. They are married so the lender would complete section (b) with their names. Section (c) would be None because Diane and Desmond are not mortgagors because neither owns the property. Eric and Erin Edwards do not have a homestead interest because they do not live at that residence so the answer to section (a) would be None.

Eric and Erin Edwards sign the mortgage, as both are titleholders.

Example 5: Francesca Foster and Fransisco Foster are married to each other. Fransisco owns the house where they live with Fransisco's parents, Georgia and Gus Foster. Georgia and Gus do not live at the house. They are refinancing a mortgage loan secured by the house where Fransisco and Francesca live.

Section (a) would list Francesca Foster and Fransisco Foster because Fransisco partially owns the house and Francesca, who is married to Fransisco, lives at the house so it is her homestead. Section (b) would be completed with Francesca and Fransisco and Gus and Georgia, and section (c) would be None.

Francesca Foster, Fransisco Foster, Gus Foster, and Georgia Foster all sign the mortgage. Fransisco, Gus, and Georgia sign as they are on title. Francesca need sign as she has a homestead interest, unless it was a purchase money mortgage. If it was a purchase money mortgage, only Fransisco, Gus and Georgia would sign as purchasers.

Example 6: Hermione Harris and Harold Harris, a married couple, are constructing a new home where they will live but only Hermione is the owner of the property. They are not living there yet but they intend to live there.

In answering the questions above, section (a) would list Hermione Harris and Harold Harris as having a homestead interest, section (b) would identify them as married, and section (c) would be None.

Who signs the mortgage? Hermione Harris would sign as she is owner of the property. As Hermione and Harold are married, the lender need consider whether Harold has homestead interest in the property. The home is not yet their homestead as it is being built, but it is their intention to have a homestead interest once the house is completed. Although the rules are not clear on when a homestead interest attaches, it is safer to have Harold also sign the mortgage since he will eventually have a homestead interest and the loan funds are being used in the construction of the home that will be the home of Hermione and Harold.

Conclusion

Lenders need be careful to take into consideration homestead interests of married Wisconsin residents when documenting a mortgage interest in real property. Under Wisconsin statute section 706.02(1)(f), if a married person is in title to the property securing the loan, the spouse of that individual will also be required to sign the mortgage if the conveyance alienates either or both spouses' homestead interest, even if the spouse is not in title. If the mortgage is a purchase money mortgage, only the purchaser is required to sign the mortgage pledging the interest of the purchased property.

Lenders also need be careful to fully complete real estate mortgage documents and to utilize language within such documents meant to help identify all individuals with a homestead interest in the property (whether those persons are Mortgagors or not), identify all of the married Mortgagors, and identify any unmarried Mortgagors. Identifying such parties can help ensure the proper parties have signed the mortgage, even if those persons are not listed as owner on a deed or in title.

Portions of this article first ran in the May 2019 *WBA Compliance Journal*.

Compliance Journal

August 2023

Special Focus

WBA wishes to thank *Jessica Schwantes, CPA and partner with Wipfli LLP* for providing this article. *Wipfli is a WBA Bronze Associate Member*. For more information about the 2023-2025 Wisconsin State Budget be sure to review last month's *WBA Compliance Journal* which may be found on the Compliance Resources page of the WBA website at: https://www.wisbank.com/resources/compliance/

Huge Tax Savings for Banks

On July 5, 2023, Governor Evers signed into law Section 71.05(1)(i) and 71.26(i) of the Wisconsin tax code with the 2023-2025 State Budget. These two sections provide significant tax savings for banks that provide business and agricultural loans to Wisconsin businesses. The estimated tax saving is $34 million in 2023 and $37 million in 2024.

The reason Section 71.05(1)(i) and Section 71.26(i) basically read the exact same is because one section is for the exclusion from individual income taxes and the other is from corporation income. The law states that *effective for taxable years beginning after December 31, 2022, income of a financial institution as defined in s. 69.30(1)(b), including interest, fees, and penalties, derived from a commercial loan of $5 million dollars or less provided to a person residing or located in Wisconsin and used primarily for a business or agricultural purposes is exempt from tax.*

The exclusion is effective for this year already. It applies to C-Corporations, S-Corporations, and S-Corporations that elect to be taxed as a C-Corporation for Wisconsin purposes. The interest, fees, and penalties earned on business and agricultural loans of $5 million or less to Wisconsin customers should be removed from your monthly state tax calculation.

We are waiting for additional guidance from the Wisconsin Department of Revenue. The current understanding is that it applies to business and agricultural loans that have a commercial loan agreement where the original principal is $5 million or less. It does not matter if the loan was issued prior to the effective date of the law of 01/01/2023. The intent of the $5 million threshold was not to create multiple smaller loans to achieve the exemption. We are expecting the additional guidance to clarify how aggregation of related transactions will occur.

The loan needs to be to a Wisconsin customer. It does not need to be a Wisconsin incorporated business or have the collateral located in Wisconsin. The customer needs to be located in Wisconsin and the use of the loan is primarily for business or agricultural purposes.

Many banks have already done the analysis to see how it impacts them. The new law may eliminate all of a bank's Wisconsin taxable income. The thing to consider with this fact pattern is whether or not a bank should record a deferred tax asset for the net operating loss carryforward that is created. A bank will have 20 years to use a Wisconsin net operating loss carryforward. Banks should consult their tax advisor to discuss the implication for the bank or contact me, Jessica Schwantes at: JSchwantes@wipfli.com or at 608-270-2931.

Again, WBA wishes to thank Jessica Schwantes, CPA and partner with Wipfli LLP for providing this article. Wipfli is a WBA Bronze Associate Member.

FTC Releases Updated Guide Concerning Use of Endorsements and Testimonials in Advertising

Over the past several years, the Federal Trade Commission (FTC) began a review of its rules and guides to determine whether existing guidance should be updated to address new methods of advertising and to prevent misrepresentations in advertising; and, on July 26, 2023, the agency released an updated *Guides Concerning the Use of Endorsements and Testimonials in Advertising* (Guide) which includes (a) definitions and general considerations, (b) recommendations for consumer, expert, and organization endorsements, (c) a disclosure of material connection, and (d) considerations for endorsements directed to children.

The Guide represents administrative interpretations of laws enforced by FTC under section 5 of the Federal Trade Commission Act (FTCA), 15 U.S.C. 45, to the use of endorsements and testimonials in advertising and includes numerous examples to illustrate the principles set forth within the Guide. As financial institutions often use endorsements or testimonials of customers in advertisements, the following is a summary of the Guide.

Select Definitions

Endorsement means any advertising, marketing, or promotional message for a product that consumers are likely to believe reflects the opinions, beliefs, findings, or experiences of a party other than the sponsoring advertiser, even if the views expressed by that party are identical to those of the sponsoring advertiser.

Verbal statements, tags in social media posts, demonstrations, depictions of the name, signature, likeness or other identifying personal characteristics of an individual, and the name or seal of an organization can be endorsements.

The party whose opinions, beliefs, findings, or experience the message appears to reflect will be called the "endorser" and could be or appear to be an individual, group, or institution. FTC stated it intends to treat endorsements and testimonials identically in the context of its enforcement of the FTCA. The term endorsements is therefore generally used within the Guide to cover both terms and situations.

Product includes any product, service, brand, company, or industry.

An **expert** is an individual, group, or institution possessing, as a result of experience, study, or training, knowledge of a particular subject, which knowledge is superior to what ordinary individuals generally acquire.

Clear and conspicuous means that a disclosure is difficult to miss (*i.e.*, easily noticeable) and easily understandable by ordinary consumers. If a communication's representation necessitating a disclosure is made through visual means, the disclosure should be made in at least the communication's visual portion; if the representation is made through audible means, the disclosure should be made in at least the communication's audible portion; and if the representation is made through both visual and audible means, the disclosure should be made in the communication's visual and audible portions.

FTC further sets forth in the Guide how a visual disclosure should stand out from other text, how an audible disclosure need be presented so that it is easy for consumers to hear and understand, and how disclosures should be made when communicating using an interactive electronic medium such as social media or the internet.

August 2023
Volume 29, Number 3

Wisconsin Bankers Association
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General Considerations and Potential Liabilities

FTC requires that endorsements reflect the honest opinions, findings, beliefs, or experience of the endorser. Furthermore, an endorsement may not convey any express or implied representation that would be deceptive if made directly by the advertiser.

An advertisement need not present an endorser's message in the exact words of the endorser unless the advertisement represents that it is presenting the endorser's exact words, such as through the use of quotation marks. However, the endorsement may not be presented out of context or reworded so as to distort in any way the endorser's opinion or experience with the product. An advertiser may use an endorsement of an expert or celebrity only so long as it has good reason to believe that the endorser continues to subscribe to the views presented. FTC recommends that an advertiser may satisfy this obligation by securing the endorser's views at reasonable intervals where reasonableness will be determined by such factors as new information about the performance or effectiveness of the product, a material alteration in the product, changes in the performance of competitors' products, and the advertiser's contract commitments.

When the advertisement represents that the endorser uses the endorsed product, FTC requires that the endorser must have been a bona fide user of it at the time the endorsement was given. Additionally, the advertiser may continue to run the advertisement only so long as it has good reason to believe that the endorser remains a bona fide user of the product.

The Guide also addresses liability for misleading endorsements. In particular, FTC reminds advertisers that advertisers are subject to liability for misleading or unsubstantiated statements made through endorsements or for failing to disclose unexpected material connections between themselves and their endorsers. FTC also cautions that an advertiser may be liable for a deceptive endorsement even when the endorser is not liable. FTC recommends advertisers should:

- Provide guidance to their endorsers on the need to ensure that their statements are not misleading and to disclose unexpected material connections;
- Monitor their endorsers' compliance; and
- Take action sufficient to remedy non-compliance and prevent future noncompliance.

Endorsers themselves may be liable for statements made in the course of their endorsements, such as when an endorser makes a representation that the endorser knows or should know to be deceptive, including when an endorser falsely represents that they personally used a product. Also, an endorser who is not an expert may be liable for misleading or unsubstantiated representations regarding a product's performance or effectiveness, such as when the representations are inconsistent with the endorser's personal experience or were not made or approved by the advertiser and go beyond the scope of the endorser's personal experience.

Endorsers may also be liable for failing to disclose unexpected material connections between themselves and an advertiser, such as when an endorser creates and disseminates endorsements without such disclosures.

Advertising agencies, public relations firms, review brokers, reputation management companies, and other similar intermediaries may be liable for their roles in creating or disseminating endorsements containing representations that they know or should know are deceptive. They may also be liable for their roles with respect to endorsements that fail to disclose unexpected material connections, whether by disseminating advertisements without necessary disclosures or by hiring and directing endorsers who fail to make necessary disclosures.

The use of an endorsement with the image or likeness of a person other than the actual endorser is deceptive if it misrepresents a material attribute of the endorser.

Consumer Endorsements

FTC provides that an advertisement employing endorsements by one or more consumers about the performance of an advertised product will be interpreted as representing that the product is effective for the purpose depicted in the advertisement. Therefore, the advertiser must possess and rely upon adequate substantiation, including, when appropriate, competent and reliable scientific evidence, to support express and implied claims made through endorsements in the same manner the advertiser would be required to do if it had made the representation directly, *i.e.*, without using endorsements. Consumer endorsements themselves are not competent and reliable scientific evidence.

FTC further sets forth that an advertisement containing an endorsement relating the experience of one or more consumers on a central or key attribute of the product will likely be interpreted as representing that the endorser's experience is representative of what consumers will generally achieve with the advertised product in actual, albeit variable, conditions of use. Therefore, FTC believes an advertiser should possess and rely upon adequate substantiation for the representation. If the advertiser does not have substantiation that the endorser's experience is representative of what consumers will generally achieve, the advertisement should clearly and conspicuously disclose the generally expected performance in the depicted circumstances, and the advertiser must possess and rely on adequate substantiation for that representation. FTC instructs that the disclosure of the generally expected performance should be presented in a manner that does not itself misrepresent what consumers can expect and to be effective, such disclosure must alter the net impression of the advertisement so that it is not misleading.

Advertisements presenting endorsements by what are represented, expressly or by implication, to be "actual consumers" should utilize actual consumers in both the audio and video, or clearly and conspicuously disclose that the persons in such advertisements are not actual consumers of the advertised product.

In procuring, suppressing, boosting, organizing, publishing, upvoting, downvoting, reporting, or editing consumer reviews of their products, advertisers should not take actions that have the effect of distorting or otherwise misrepresenting what consumers think of their products, regardless of whether the reviews are considered endorsements under the Guide.

Expert Endorsements

Whenever an advertisement represents, expressly or by implication, that the endorser is an expert with respect to the endorsement message, FTC then requires that the endorser's qualifications must in fact give the endorser the expertise that the endorser is represented as possessing with respect to the endorsement.

Although an expert may, in endorsing a product, take into account factors not within the endorser's expertise (such as taste or price), FTC requires the endorsement be supported by an actual exercise of the expertise that the expert is represented as possessing in evaluating product features or characteristics which are relevant to an ordinary consumer's use of or experience with the product. FTC requires the evaluation have included an examination or testing of the product at least as extensive as someone with the same degree of represented expertise would normally need to conduct in order to support the conclusions presented in the endorsement. To the extent that the advertisement implies that the endorsement was based upon a comparison to another product or other products, such comparison must have been included in the expert's evaluation; and as a result of such comparison, the expert must have concluded that, with respect to those features on which the endorser is represented to be an expert and which are relevant and available to an ordinary consumer, the endorsed product is at least equal overall to the competitors' products. Moreover, where the net impression created by the endorsement is that the advertised product is superior to other products with respect to any such feature or features, then the expert must in fact have found such superiority.

Endorsements by Organizations

Endorsements by organizations, especially expert ones, FTC believes are viewed as representing the judgment of a group whose collective experience exceeds that of any individual member, and whose judgments are generally free of the sort of subjective factors that vary from individual to individual. Therefore, FTC requires that an organization's endorsement be reached by a process sufficient to ensure that the endorsement fairly reflects the collective judgment of the organization. Moreover, if an organization is represented as being expert, then, in conjunction with a proper exercise of its expertise in evaluating the product as set forth in the preceding paragraph, it must utilize an expert or experts recognized as such by the organization or standards previously adopted by the organization and suitable for judging the relevant merits of such products.

Disclosure of Material Connections

When there exists a connection between the endorser and the seller of the advertised product that might materially affect the weight or credibility of the endorsement, and that connection is not reasonably expected by the audience, FTC requires that such connection be disclosed clearly and conspicuously. Material connections can include a business, family, or personal relationship. They can include monetary payment or the provision of free or discounted products (including products unrelated to the endorsed product) to an endorser, regardless of whether the advertiser requires an endorsement in return. FTC further provides that material connections can also include other benefits to the endorser, such as early access to a product or the possibility of being paid, of winning a prize, or of appearing on television or in other media promotions. Some connections may be immaterial because they are too insignificant to affect the weight or credibility given to endorsements. A material connection needs to be disclosed when a significant minority of the audience for an endorsement does not understand or expect the connection. A disclosure of a material connection does not require the complete details of the connection, but it must clearly communicate the nature of the connection sufficiently for consumers to evaluate its significance.

Endorsements Directed at Children

The last section of the Guide addresses endorsements that are directed at children. In particular, FTC cautions that endorsements in advertisements addressed to children may be of special concern because of the character of the audience. Practices that would not ordinarily be questioned in advertisements addressed to adults might be questioned in such cases.

Examples

As previously mentioned, FTC has provided many examples throughout the Guide to further illustrate the principles set forth by FTC. Review of the examples is helpful to further understand FTC instruction and expectations. The Guide may be viewed at: www.govinfo.gov/content/pkg/FR-2023-07-26/pdf/2023-14795.pdf

Special Focus

New Resources Available to All WBA-Member Bankers: *WBA Legal In-House Compliance Training, WBA Account Titling Video Series, and other Banker Guides*

As part of the Wisconsin Bankers Association's (WBA) mission to support bankers across the state, our team — often in collaboration with the membership — regularly creates resources to assist WBA-member bankers in expanding their knowledge and expertise. Recently, WBA launched several valuable compliance resources that your staff will find useful in maneuvering the ever-changing banking compliance landscape. Our objective with these services is to continue to make training accessible and more flexible for all WBA members at a reasonable cost.

WBA Legal is excited to announce its new **WBA Legal In-House Compliance Training** resource for member banks to take advantage of where the WBA Legal team brings compliance training directly to your bank. The training may be conducted in-person or as a virtual meeting and will be customized to your bank's needs. All training will be conducted by WBA Legal; the presenter selected is dependent on the topic and timing of the training.

Additionally, WBA Legal is also excited to share that the new **WBA Account Titling Video Series** is now available. This series is designed for your bank to use as a new employee onboarding tool or a refresher for frontline retail staff. The series is built upon WBA's longstanding and popular, comprehensive account titling workshop and is meant to help frontline staff develop an awareness of the laws related to account titling, analyze a variety of deposit account ownerships and fiduciary roles of deposit account relationships, recognize the legal and practical importance of an account title, and identify various documents which make up a deposit contract and understand their significances.

The new series provides information about account titling in short, topic-specific videos. Each video is supported by written materials. When utilizing the videos as training, there are also exercises to illustrate concepts shared within the videos. Managers are encouraged to supplement the information in the series with bank-specific policies, procedures, and operational requirements, so frontline staff know of any additional actions bank management expects frontline staff to execute.

The new resource consists of 11 modules, covering 60 topics with over five hours of video material! Each video ranges between two and 10 minutes in length — making training very flexible. Also included are manager/trainer resources such as a viewing sequence listing, tracking resource, examples, and test questions with an answer key.

As the WBA Legal team has provided for decades, new materials and resources are routinely added to the **WBA Compliance page** on the WBA website, and WBA Legal encourages your compliance team to monitor this site and WBA e-publications for updates. The newest release is a **Lender's Guide to the Marital Property Act**. The guide answers frequently asked questions lenders have regarding the Act and is just one of several other available guides for members. Other such resources include a **Banker's Guide to LLCs** and a **Transfer by Affidavit Guide**.

Finally, many other resources created by bankers serving on various WBA Sections and Committees may be found in the **WBA Best Practices Library**, also on the WBA website. The Best Practices Library is password protected. If you do not have the password, please reach out to WBA Legal at wbalegal@wisbank.com

WBA strives to provide comprehensive compliance resources for its members. If you have requests for new content or other materials, please let WBA Legal know and we will incorporate all feedback into our new product development process.

Resources:

WBA Legal In-House Compliance Training:
www.wisbank.com/resources/compliance/compliance-training/

WBA Account Titling Video Series:
https://web.cvent.com/event/f0f44782-65f4-4122-82cd-b24fce138dd0/summary

Special Focus

WBA Legal Compliance Page:
www.wisbank.com/resources/compliance/

WBA Legal Lender's Guide to Marital Property Act:
www.wisbank.com/wp-content/uploads/2023/07/Lenders-Guide-to-Marital-Property-Act-Final.pdf

WBA Best Practice Library:
www.wisbank.com/resources/best-practices-library/

Regulatory Spotlight

Agencies Issue Semi-Annual Regulatory Agendas.

The Bureau of Consumer Financial Protection Bureau (CFPB) published an agenda as part of the Spring 2023 Unified Agenda of Federal Regulatory and Deregulatory Actions. CFPB reasonably anticipates having the regulatory matters identified in the agenda under consideration during the period from **06/01/2023**, through **05/31/2024**. The next agenda will be published in Fall 2023 and will update this agenda through Fall 2024. Publication of the agenda is in accordance with the Regulatory Flexibility Act. The information is current as of **03/22/2023**. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-07-27/pdf/2023-14564.pdf. *Federal Register*, Vol. 88, No. 143, 07/27/2023, 48632-48633.

The Board of Governors of the Federal Reserve System (FRB) issued a semiannual agenda under the Regulatory Flexibility Act and FRB's Statement of Policy Regarding Expanded Rulemaking Procedures. FRB anticipates having under consideration regulatory matters as indicated in the agenda during the period **05/01/2023**, through **10/31/2023**. The next agenda will be published in Fall 2023. Comments may be submitted any time during the next 6 months. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-07-27/pdf/2023-14556.pdf. *Federal Register*, Vol. 88, No. 143, 07/27/2023, 48682-48683.

The Department of the Treasury (Treasury) issued a notice pursuant to the requirements of the Regulatory Flexibility Act and Executive Order 12866, which require the publication by Treasury of a semi-annual agenda of regulations. The agenda includes regulations that Treasury has issued or is expected to issue and rules currently in effect that are under review. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-07-27/pdf/2023-14550.pdf. *Federal Register*, Vol. 88, No. 143, 07/27/2023, 48592-48596.

The Small Business Administration (SBA) issued its semi-annual regulatory agenda which is a summary of current and projected rulemakings and completed actions of SBA. SBA invites comments regarding the agenda. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-07-27/pdf/2023-14552.pdf. *Federal Register*, Vol. 88, No. 143, 07/27/2023, 48614-48616.

The Department of Labor (DOL) issued its semi-annual agenda of regulations. The internet has become the means for disseminating the entirety of DOL's semi-annual regulatory agenda. However, the Regulatory Flexibility Act requires publication of a regulatory flexibility agenda in the *Federal Register*. The notice contains DOL's regulatory flexibility agenda. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-07-27/pdf/2023-14548.pdf. *Federal Register*, Vol. 88, No. 143, 07/27/2023, 48576-48580.

The Federal Communications Commission (FCC) published its semi-annual regulatory agenda. Twice a year, in spring and fall, FCC publishes in the *Federal Register* a list in the Unified Agenda of the major items and other significant proceedings under development or review that pertain to the Regulatory Flexibility Act. The Unified Agenda also provides the Code of Federal Regulations citations and legal authorities that govern the proceedings. The complete Unified Agenda will be published at: www.reginfo.gov. The notice may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-07-27/pdf/2023-14555.pdf. *Federal Register*, Vol. 88, No. 143, 07/27/2023, 48642-48680.

Wisconsin Bankers
ASSOCIATION

Compliance Journal
July 2023

Special Focus

Wisconsin 2023–2025 Budget Recap for Bankers

Earlier this month, Governor Evers approved Senate Bill 70 as 2023 Wisconsin Act 19, which establishes Wisconsin's 2023–2025 Budget. The following recaps business-related provisions from Act 19, which should be of interest to bankers.

Tax-Exemption for Income Earned From Small Business and Ag Purpose Loans

One of the most important provisions of Act 19 is a new tax-exemption for banks related to certain business and agricultural lending. Act 19 creates new sections 71.05(1)(i) and 71.26(1)(i) which provides that income from a tax-option corporation bank and income of a bank that is derived from a commercial loan of $5 million or less provided to a person residing or located in Wisconsin and used primarily for business or agricultural purpose is exempt. A tax-option corporation bank means a S-corporation bank. The treatment of sections 71.05(1)(i) and 71.26(1)(i) first applies to taxable years beginning after December 31, 2022.

An FAQ has been developed by WBA Legal to answer frequently asked questions related to the tax-exemption. The FAQ is found later in this publication.

Funding for New WHEDA Programs and Increase to Capital Reserve Funding Bonding Limit

In late June, four bills were signed into law meant to help expand affordable housing in Wisconsin. The budget then provided one-time funding for the programs. In particular,

2023 Wisconsin Act 14 created a residential housing infrastructure revolving loan fund program. The program allows a residential developer to apply to the Wisconsin Housing and Economic Development Authority (WHEDA) for a loan to cover the costs of installing, replacing, upgrading, or improving public infrastructure related to workforce housing and senior housing. The infrastructure loan must be for new single-family or multi-family housing for rent or for sale.

If WHEDA awards an infrastructure loan to a developer, it may also award a loan to the local government that approved the developer's loan for the purpose to cover infrastructure costs incurred in connection with the developer's project. The loan to the local government may not exceed 10 percent of the amount of the developer's loan. Act 19 provided one-time funding of $275 million for the new residential housing infrastructure revolving loan fund program.

2023 Wisconsin Act 15 created a main street housing rehabilitation revolving loan fund which allows an owner of rental housing to apply to WHEDA for a loan to cover the costs of improvements to workforce housing, which includes remediation of lead paint or asbestos. A project is eligible if it is for housing rehabilitation of single-family or multi-family rental housing which meet the conditions required under the program. Act 19 provided one-time funding of $100 million for the new main street housing rehabilitation revolving loan fund.

2023 Wisconsin Act 17 created a workforce housing rehabilitation loan program which allows for a person to apply to WHEDA for a loan to pay the costs of certain rehabilitation of the applicant's single-family home. The home must be occupied by the applicant and must have been constructed at least forty years before the date of the application. The rehabilitation need be one considered eligible under the program. Act 19 provided one-time funding of $50 million to support the housing rehabilitation program.

2023 Wisconsin Act 18 created a commercial-to-residential conversion revolving loan fund program under which a developer may apply to WHEDA for a loan to cover the costs to convert a vacant commercial building to workforce housing or senior living. The housing associated with the conversion loan must be new residential housing for rent or for sale and must consist of 16 or more dwelling units. A vacant building is eligible for the program if it had been vacant for at least one year and is zoned for residential use. Additionally, housing associated with the conversion loan must remain workforce housing or senior housing for ten years filing initial occupancy. Act 19 provided one-time funding of $100 million for the new commercial-to-housing revolving fund loan.

The budget also increased the limit on notes and bonds that WHEDA may issue which are secured by a capital reserve fund from $800 million to $1 billion. The increase will allow WHEDA to continue to finance projects supported with an allocation of state and federal housing tax credits.

Increased Shared Revenue for Municipalities

Act 19 funded changes made by 2023 Wisconsin Act 12 which increased shared revenue and funding to emergency services. Overall, the added aid for municipalities for fiscal year 2024–2025 represents a 36 percent increase over current county and municipal aid entitlements. The budget also provides over $178 million in aid payments to local governments to assist with the repeal of the personal property tax further outlined later in this publication.

Income Tax Reduction for Two Lowest Tax Brackets

The 2023–2025 Budget provides an income tax reduction for Wisconsin's two lowest tax brackets. The Governor vetoed cuts to the top two brackets, leaving over $3 billion dollars to go back into the general fund. Act 19 reduces the lowest tax bracket from 3.54 percent to 3.5 percent and reduces the second lowest tax bracket from 4.65 percent to 4.4 percent. The reductions are effective for tax year 2023.

Increase in Retailer Vendor Compensation

As a general requirement under section 77.53(3), every retailer engaged in business in Wisconsin and making sales of tangible personal property, goods, or taxable services, must at time of making the sales, collect the tax from the purchaser and give the purchaser a receipt in a manner and form prescribed by Wisconsin Department of Revenue (DOR). The retailers currently have a deduction of those taxes payable.

Act 19 revised section 77.61(4)(c) so that for reporting the sales tax and collecting and reporting the use tax imposed on a retailer under section 77.53(3), the retailer may deduct 0.75 percent of those taxes payable or $10 for that reporting period and may claim a maximum of $8,000 for that reporting period, whichever is greater, as administrative expenses. This is an increase from 0.5 percent and $1,000, respectively.

With this increase in retailer vendor compensation, WBA is hopeful the increase will reduce the interest by retailers of a state credit card interchange fee. The treatment of section 77.61(4)(c) first applies to sales and use taxes payable on the first day of the third month beginning after publication of the Act.

Sales and Use Tax-Exemption for Equipment or Software Used at Qualified Data Center

Act 19 creates section 77.54(70), which sets forth a sales and use tax-exemption for equipment or software used for the processing, storage, retrieval, or communication of

July 2023
Volume 29, Number 2

Wisconsin Bankers Association
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data at a qualified data center, as certified by the Wisconsin Economic Development Corporation (WEDC).

A "qualified data center" is defined under new section 238.40(1)(b) to mean one or more buildings or an array of connected buildings owned, leased, or operated by the same business entity, as defined in section 13.62(5), or its affiliate and for which all of the following apply:

1. The buildings are rehabilitated or constructed to house a group of networked server computers in one physical location or multiple locations in order to centralize the processing, storage, management, retrieval, communication, or dissemination of data and information.

2. The buildings create a minimum qualified investment in Wisconsin of any of the following amounts within 5 years from the date on which WEDC certifies the data center as eligible to claim the exemption under section 77.54(70):

    a. For buildings located in a county having a population greater than 100,000, $150,000,000.
    b. For buildings located in a county having a population greater than 50,000 and not more than 100,000, $100,000,000.
    c. For buildings in a county having a population of not more than 50,000, $50,000,000.
    d. For buildings located in more than one county, the amount provided under subd. 2. a., b., or c. for the most populous county in which the buildings are located.

The treatment of sections 77.54(70) and 238.40 take effect on the first day of the third month beginning after publication of Act 19.

Agricultural-Related Funding Increases

Act 19 also provides funding for several agricultural-focused programs. In particular, $1 million was allocated for both years for agricultural export efforts under the Wisconsin Initiative for Agricultural Export Program (WIAE); an additional $300,000 both years for the dairy processor grant program which provides grants for up to $50,000 to help foster innovation, improve profitability, and sustain long-term viability of dairy processing facilities; and more funding to support the meat processor grant program and to fulfill federal expenditure requirements for the meat inspection program. Act 19 also provides $100,000 for farmer mental health assistance for both years.

Repeal of Personal Property Tax

While not a matter accomplished through the budget, the repeal of Wisconsin's personal property tax is worth mentioning as it is a fiscal-related topic. Signed into law on June 20, 2023, 2023 Wisconsin Act 12, fully repealed Wisconsin's longstanding personal property tax beginning with property tax assessments as of January 1, 2024. The law is effective in 2024, so financial institutions will need to continue to monitor current year assessments as institutions remain responsible for personal property taxes related to 2023 filings.

Act 12 made changes to chapter 71 to remove "personal" from the definitions of "property taxes" and "property taxes accrued" leaving real property taxes as included in the definitions.

Additionally, Act 12 creates section 70.17(3), which provides that beginning with the property tax assessment as of January 1, 2024, manufactured and mobile homes, not otherwise exempt from taxation under section 66.0435(3), will be assessed as real property. Buildings, improvements, and fixtures on leased lands; buildings, improvements, and fixtures on exempt lands; buildings, improvements, and fixtures on forest croplands; and buildings, improvements, and fixtures on managed forest lands will also be assessed as real property. If buildings, improvements, and fixtures, but not the underlying land, are leased to a person other than the landowner or if the buildings, improvements, and fixtures are owned by a person other than the landowner, the assessor may create a separate tax parcel for the buildings, improvements, and fixtures and assess the buildings, improvements, and fixtures as real property to the owner of the buildings, improvements, and fixtures. These changes make important distinctions between personal property and real property and are topics that should be further discussed and monitored with accounting and tax resources, as applicable.

Conclusion and Resources

Wisconsin's 2023–2025 Budget included several provisions which impact financial institutions, most notably the tax-exemption for income earned on business and agricultural purpose loans of $5 million dollars and less made to a person residing or located in Wisconsin. In addition, new and added funding has been allotted to programs that enhance and improve housing programs, farm programs, and other business-related incentives.

Be sure to review the FAQ developed by WBA Legal related to the tax-exemption for income earned from certain small business and agricultural purpose loans. The FAQ is found later in this publication.

The WBA is currently collecting other resources for the membership on the recent changes, including a future *WBA Compliance Journal* article by WBA Silver Associate Member Wipfli LLP and upcoming free member webinar by WBA Bronze Associate Member Eide Bailly LLP. Registration for the webinar may be found on the WBA website at: https://www.wisbank.com/events/free-member-webinar-wisconsin-state-tax-update-for-banks-historic-legislation/

Links to the Acts referenced above:

2023 Wisconsin Act 12: https://docs.legis.wisconsin.gov/2023/related/acts/12.pdf

2023 Wisconsin Act 14: https://docs.legis.wisconsin.gov/2023/related/acts/14.pdf

2023 Wisconsin Act 15: https://docs.legis.wisconsin.gov/2023/related/acts/15.pdf

2023 Wisconsin Act 17: https://docs.legis.wisconsin.gov/2023/related/acts/17.pdf

2023 Wisconsin Act 18: https://docs.legis.wisconsin.gov/2023/related/acts/18.pdf

2023 Wisconsin Act 19: https://docs.legis.wisconsin.gov/2023/related/acts/19.pdf

Agencies Update Policy Statement on Prudent CRE Loan Accommodations and Workouts

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), in consultation with state bank and credit union regulators, issued a final policy statement for prudent commercial real estate (CRE) loan accommodations and workouts. The updated policy statement builds on existing supervisory guidance calling for financial institutions to work prudently and constructively with creditworthy borrowers during times of financial stress.

In particular, the statement addresses prudent risk management practices regarding short-term loan accommodations, risk management for loan workout programs, long-term loan workout arrangements, classification of loans, and regulatory reporting and accounting requirements and considerations. The statement also includes selected references and materials related to regulatory reporting. The statement does not, however, affect existing regulatory reporting requirements or supervisory guidance provided in relevant interagency statements issued by the agencies or accounting requirements under U.S. generally accepted accounting principles (GAAP). Certain principles in the statement are also generally applicable to commercial loans that are secured by either real property or other business assets of a commercial borrower.

The agencies incorporated five appendices into the statement:

- Appendix 1 contains examples of CRE loan workout arrangements to illustrate the application of the statement to classification of loans and determination of nonaccrual treatment.
- Appendix 2 lists selected relevant rules as well as supervisory and accounting guidance for real estate lending, appraisals, allowance methodologies, restructured loans, fair value measurement, and regulatory reporting matters

such as nonaccrual status. The agencies intend the statement to be used in conjunction with materials identified in Appendix 2 to reach appropriate conclusions regarding loan classification and regulatory reporting.
- Appendix 3 discusses valuation concepts for income-producing real property.
- Appendix 4 provides the special mention and adverse classification definitions used by FRB, FDIC, and OCC.
- Appendix 5 addresses the relevant accounting and supervisory guidance on estimating loan losses for financial institutions that use the current expected credit losses (CECL) methodology.

Importantly, the agencies stated recognition that financial institutions face significant challenges when working with CRE borrowers who are experiencing diminished operating cash flows, depreciated collateral values, prolonged sales and rental absorption periods, or other issues that may hinder repayment. While such borrowers may experience deterioration in their financial condition, many borrowers will continue to be creditworthy and have the willingness and ability to repay their debts. In such cases, financial institutions may find it beneficial to work constructively with borrowers. Such constructive efforts may involve loan accommodations or more extensive loan workout arrangements.

The updated statement provides a broad set of risk management principles relevant to CRE loan accommodations and workouts in all business cycles, particularly in challenging economic environments. The statement also describes the approach examiners will use to review CRE loan accommodation and workout arrangements and provides examples of CRE loan workout arrangements as well as useful references in the appendices.

The agencies stated each expect their examiners to take a balanced approach in assessing the adequacy of a financial institution's risk management practices for loan accommodation and workout activities. Consistent with the Interagency Guidelines Establishing Standards for Safety and Soundness, financial institutions that implement prudent CRE loan accommodation and workout arrangements after performing a comprehensive review of a borrower's financial condition will not be subject to criticism for engaging in these efforts, even if the arrangements result in modified loans that have weaknesses that result in adverse classification.

In addition, modified loans to borrowers who have the ability to repay their debts according to reasonable terms will not be subject to adverse classification solely because the value of the underlying collateral has declined to an amount that is less than the outstanding loan balance.

Financial institutions should review the updated policy statement and compare the guidance within to existing loan workout policy and procedures to ensure new recommendations and expectations are incorporated, as applicable. The updated policy statement may be viewed at: https://www.govinfo.gov/content/pkg/FR-2023-07-06/pdf/2023-14247.pdf

Wisconsin State Tax-Exemption for Income Earned from Business and Ag Purpose Loans

An important provision of 2023 Wisconsin Act 19 (also known as Wisconsin's 2023–2025 Biennial Budget) is a new, historic tax-exemption for banks related to certain business and agricultural lending. Act 19 creates new sections 71.05(1)(i) and 71.26(1)(i). This has been an advocacy priority for WBA for quite some time.

Section 71.05 provides a list of exemptions and excluded income which are exempt from taxation under an income computation of individuals and fiduciaries. New section 71.05(1)(i) reads as: *Commercial loans*. Income from a tax–option corporation that is a financial institution, as defined in s. 69.30(1)(b), including interest, fees, and penalties, derived from a commercial loan of five million dollars or less provided to a person residing or located in this state and used primarily for a business or agricultural purpose.

Section 71.26 provides a list of exemptions and excluded income which are exempt from taxation under an income computation of corporations. New section 71.26(1)(i) reads as: *Commercial loans*. Income of a financial institution, as defined in s. 69.30(1)(b), including interest, fees, and penalties, derived from a commercial loan of five million dollars or less provided to a person residing or located in this state and used primarily for a business or agricultural purpose.

The treatment of sections 71.05(1)(i) and 71.26(1)(i) first applies to taxable years beginning after December 31, 2022.

<u>The following is a list of questions and answers regarding the new tax-exemption based upon information currently available to WBA</u>. WBA does plan to have conversations with the Wisconsin Department of Revenue regarding the implementation of this new law. As a result, this document will be updated as new questions arise or additional information is provided to WBA. *It is important to remember that intentionally structuring larger business or agricultural purpose loan transactions to lower the loan amount to $5 million or less is anticipated to not be permitted.*

Q1. What types of financial institutions qualify for this exemption?

A1. Financial institutions that meet the definition of s. 69.30(1)(b), Wis. Stats., are eligible for this tax exemption. That state statute defines "financial institution" to mean any bank, savings bank, savings and loan association or credit union that is authorized to do business under state or federal laws relating to financial institutions.

Q2. Does the exemption apply to both C-corporation and S-corporation banks?

A2. Yes, the exemption applies to both C-corporation and S-corporation banks. S-corporations under Wisconsin law are referred to as tax-option corporations.

Q3. Must a tax-option corporation bank (a/k/a S-corporation bank) pay Wisconsin tax at the entity level in order to receive the tax exemption, or may it pay tax at the individual/trust shareholder level and still receive the tax-exemption?

A3. The tax exemption may be realized at either level. If the tax-option corporation bank elects to pay Wisconsin tax at the entity level, the entity will be able to claim the exclusion. If instead the tax-option corporation bank pays tax at the individual or trust shareholder level, the shareholder should also be able to claim the exclusion on their pro rata share of the S-corporation bank's income.

Q4. When does the new exemption apply?

A4. The exemption first applies to taxable years beginning after December 31, 2022.

Q5. Does the exemption only apply to new loans?

A5. The exemption applies to existing business and agricultural loans on the books as of January 1, 2023, if the loan is $5 million or less and the borrower resides or is located in Wisconsin. For such loans, the exemption applies to the interest, fee and penalty income earned by the bank in 2023 but not before. The exemption applies to new loans so long as the dollar amount, principal purpose, and residence or location requirements are met.

Q6. Does the use of the word "person" in the new statutory sections mean the loan must be made to an individual for the exemption to apply or may the loan also be made to an entity?

A6. The use of the word "person" does not mean only a natural living being. The use of the word "person" in Wisconsin Statutes includes all partnerships, associations, and bodies of politic or corporate. For the exemption to apply, the loan must be $5 million or less, must be primarily for a business or agricultural purpose, and must be made to a person residing or located in Wisconsin. "Person" includes a natural person or entity.

Q7. Does an entity borrower need to be an entity that was organized under Wisconsin law for the exemption to apply?

A7. The exemption does not look to where the entity borrower was organized. For the exemption to apply, the loan must be made to a person residing or located in Wisconsin.

Q8. Does collateral for the loan need to be located in Wisconsin for the exemption to apply?

A8. The exemption does not look to where the collateral is located but rather where the borrower is located. For the exemption to apply, the loan must be made to a person residing or located in Wisconsin.

Q9. Does it matter what cross-collateralizes the loan for the exemption to apply?

A9. The exemption focuses on the primary purpose of the loan and not what collateral is securing the loan. The primary purpose of the loan must be for a business or agricultural purpose to a person residing or located in Wisconsin.

Q10. Does the guarantor need to reside or be located in Wisconsin for the exemption to apply?

A10. The exemption does not look to where the guarantor, if any, is located but rather where the borrower is located. For the exemption to apply, the loan must be made to a person residing or located in Wisconsin.

Q11. Does the exemption only apply to certain types of business loans, such as only to C&I or only to CRE loans?

A11. The exemption does not distinguish between types of business or agricultural loans. The exemption applies to a commercial loan that is primarily for a business or agricultural purpose, of $5 million dollars or less, provided to a person residing or located in Wisconsin.

Q12. What does it mean for a loan to be "used primarily for a business or agricultural purpose."

A12. The words should carry the same plain meaning as in existing, routinely used banking regulations and rules, including under standards found in the Truth in Lending Act and Equal Credit Opportunity Act.

Q13. What income is exempt under the new law?

A13. Income includes interest, fees and penalties derived from the qualified loan as provided in the loan documents with the eligible borrower(s).

Wisconsin Bankers
ASSOCIATION

Compliance Journal
June 2023

Special Focus

Amended Wisconsin Supreme Court Rules Affect Lawyer Trust Accounts

As further outlined below, Wisconsin Supreme Court Rules (SCR) have been amended to allow greater flexibility for electronic transactions in lawyer trust accounts. The rules are effective **July 1, 2023**. WBA has received permission from the Wisconsin State Bar to run the article below by the State Bar and the Office of Lawyer Regulation (OLR) which summarizes the amendments.

In addition, IOLTA participating financial institutions should have received a letter from OLR regarding the amendments. The letter briefly outlines the new rule. In addition, the letter addresses amended SCR 20:1.15(f)(1) which requires lawyers to maintain commercially reasonable security measures in their trust accounts and requires lawyers to cover any negative balance caused by a chargeback, surcharge, or ACH reversal. The letter recommends lawyers should arrange with their banks for any surcharge, fee, reversal, or chargebacks to be withdrawn from an operating account rather than from a trust account. Banks should be prepared for the potential ask from their lawyer customers and to determine how operationally this may be accomplished.

It remains the responsibility of the lawyer to select the appropriate type of lawyer trust account. No changes need be made to bank procedures other than to know there is now greater flexibility for electronic transactions and that lawyers may request to combine certain lawyer trust accounts.

2023 Amendments to the Trust Account Rule: Electronic Transactions Permitted

On March 30, 2023, the Wisconsin Supreme Court issued an order amending the lawyer trust account rule, SCR 20:1.15, removing prohibitions on electronic transactions and providing lawyers greater flexibility in handling client funds. The newly amended SCR 20:1.15 will become effective **July 1, 2023** (2023 Rule) and represents a major change in the regulation of lawyer trust accounts in Wisconsin.

Going forward, Wisconsin lawyers, like lawyers in most other jurisdictions, will be able to make electronic transactions into and out of their trust accounts without the use of additional specialized trust accounts, like the E-Banking Trust Account. Moreover, the new amendments to the rule do not prohibit lawyers from doing anything they are currently permissibly doing, so the amendments will not serve as a “gotcha” for those who are not timely aware.

Before addressing the implications of the new amendments to the trust account rule, it is helpful to review the landscape of electronic payments under the version of SCR 20:1.15 in effect from July 1, 2016, through June 30, 2023 (2016 Rule).

Electronic Transactions in the Pre-July 2023 Trust Account Rule

The 2016 Rule had arguably the most restrictive prohibitions on electronic transactions in the United States.[1] This was problematic both for lawyers and clients wishing to use modern banking methods for payment of legal fees and costs and to disburse funds from lawyer trust accounts for filing fees and other purposes.

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[1] For more information, see Timothy J. Pierce, *E-banking: Modernizing Trust Account Rules*, 89 Wis. Law. (July/Aug. 2016). https://www.wisbar.org/NewsPublications/WisconsinLawyer/Pages/Article.aspx?Volume=89&Issue=7&ArticleID=24966.

Under the 2016 Rule, SCR 20:1.15(f)(2)c. prohibited third parties from making electronic transfers to or from a trust account. Also under the 2016 Rule, SCR 20:1.15(f)(3) prohibited lawyers from making electronic transfers as well, except that lawyers could make remote deposits provided the lawyer and financial institution keep appropriate records of each remote deposit.

The practical effect of these two provisions was that, under the 2016 Rule, lawyers could only disburse money from their trust account by paper check or wire transfer and clients and third parties could only pay money to trust accounts by cash, paper check, or wire transfer.

The 2016 Rule carved out two limited exceptions that allowed lawyers to engage in electronic transactions in their trust account.

The first exception in the 2016 Rule was found in SCR 20:1.15(f)(3)(b) and was known as the "E-Banking Trust Account." This option required lawyers to keep two separate IOLTA trust accounts: the primary trust account and a second E-Banking Trust Account, which acts as a "pass through" account. A lawyer could both send and receive money electronically in the E-Banking Trust Account, but the lawyer had to disburse the funds to the regular trust account within three business days of availability.

In addition, the E-Banking Trust Account had to be an IOLTA account and was subject to all the other provisions of SCR 20:1.15, including the record keeping requirements of SCR 20:1.15(g). Thus, lawyers using this option had to incur the administrative costs of maintaining two trust accounts, including keeping two sets of trust account records.

The second exception under the 2016 Rule was found in SCR 20:1.15(f)(c) and known colloquially as the "All-in-One Trust Account." This option allowed lawyers to maintain just one trust account and use it for all purposes, including electronic transactions, provided the lawyer complied with four additional security requirements.

First, the lawyer had to maintain commercially reasonable account security for electronic transactions. Second, the lawyer had to maintain a crime insurance policy or bond in an amount sufficient to cover the maximum daily account balance during the prior calendar year. Third, the lawyer had to arrange for all chargebacks, ACH reversals, monthly fees, and fees deducted from deposits to be deducted from the lawyer's operating account, or the lawyer had to replace any and all funds withdrawn within three business days of receiving actual notice, and the lawyer had to do so prior to disbursing any funds from the trust account. Fourth, the lawyer had to record in the financial institution's electronic payment system the date, amount, payee, client matter, and reason for each disbursement.

While the All-in-One Trust Account exception allowed lawyers to maintain just one trust account and one set of trust account records, the lawyer was required to maintain a potentially expensive crime insurance policy or bond. The one insurer that had worked with the State Bar of Wisconsin and the Office of Lawyer Regulation to develop a suitable crime insurance policy announced in 2022 it would no longer be writing or renewing any such policies, and lawyers have reported significant difficulty in finding other carriers willing to issue this specialized coverage.

Alternative Protection for Advanced Fees

Aside from the two exceptions set out in the 2016 Rule, there was only one other method for lawyers to accept electronic payments for advanced fees: the "alternative protection for advanced fees" found in the fee rule, SCR 20:1.5(g). This option remains available under the 2023 Rule.

June 2023
Volume 29, Number 1

Wisconsin Bankers Association
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The alternative protection for advanced fees is the only exception to the general duty to hold client funds in trust under SCR 20:1.15(b)(1). It is limited to advanced fees only, and they must be paid directly to the operating account rather than the trust account. This option does not apply to cost advances, which must still be held in a trust account.

Under SCR 20:1.5(g), a lawyer may accept payments for advanced fees, including electronic payments, directly to the lawyer's operating account rather than depositing the advanced fee into a trust account, provided that the lawyer's fee is subject to review by a court of competent jurisdiction in the proceeding to which the fee relates, or the lawyer complies with all of the following requirements.

To begin with, upon receiving an advanced fee, the lawyer must provide written notice to the client of the obligation to refund unearned fees, the availability of fee arbitration, and the availability of reimbursement by the Wisconsin Lawyers' Fund for Client Protection, as well as other information relating to the rate of the fee and the anticipated expenses.

At termination of the representation, the lawyer must account for any fees not previously accounted for and promptly refund any unearned fees. The lawyer must also notify the client that, if the client disputes the fee and wants to arbitrate that dispute, the client must provide the lawyer with written notice of such dispute within 30 days of the lawyer's mailing the accounting.

Upon receipt of timely notice that a client disputes the fee, the lawyer must either resolve the dispute or submit it to binding arbitration within 30 days, provided the client agrees to arbitration. Finally, once a lawyer receives notice of an arbitration award in the client's favor, the lawyer must pay that award within 30 days.

The 2023 amendments to the trust account rule do not affect the SCR 20:1.5(g) alternative protection for advanced fees, which remains an option for accepting payment.

Changes to Electronic Transactions Effective July 1, 2023

The most significant change to the trust account rule is the repeal of SCR 20:1.15(f)(2)c. and SCR 20:1.15(f)(3), which under the 2016 Rule prohibited third parties and lawyers from electronically transferring funds to or from a trust account. The result is lawyers will now be able to make electronic transactions in their trust accounts, and allow third parties to do so as well, so long as the other requirements of SCR 20:1.15 are followed.

To ensure the security of all transactions, electronic or otherwise, SCR 20:1.15(f)(1) has been amended as follows (amendments underlined):

> "(f)(1) **Security of transactions**. A lawyer is responsible for the security of each transaction in the lawyer's trust account and shall not conduct or authorize transactions for which the lawyer does not have commercially reasonable security measures in place. A lawyer shall establish and maintain safeguards to assure that each disbursement from a trust account has been authorized by the lawyer and that each disbursement is made to the appropriate payee. <u>Every check, draft, electronic transfer, or other withdrawal instrument or authorization shall be personally signed or, in the case of electronic, telephone, or wire transfer, directed by one or more lawyers authorized by the law firm or a person under the supervision of a lawyer having responsibility under SCR 20:5.3. A lawyer shall reimburse the trust account for any shortfall or negative balance caused by a chargeback, surcharge, or ACH reversal by a financial institution or card issuer within three business days of receiving actual notice that a chargeback, surcharge, or ACH reversal has been made against the trust account; and the lawyer shall reimburse the trust account for any shortfall or negative balance caused by a chargeback, surcharge, or ACH reversal prior to disbursing funds from the trust account.</u>"

ELECTRONIC BANKING

PERMITTED ELECTRONIC TRANSACTIONS TO A TRUST ACCOUNT

SCR 20:1.15(f)(1) and WISCONSIN COMMENT

ELECTRONIC TRANSFERS TO AND FROM THE TRUST ACCOUNT ARE PERMITTED IF SUCH TRANSFERS ARE AUTHORIZED IN ADVANCE BY THE LAWYER OR A PERSON UNDER THE LAWYER'S DIRECT SUPERVISION. ANY CHARGEBACK, SURCHARGE, OR ACH REVERSAL, MUST BE REPLACED BY THE LAWYER WITHIN THREE BUSINESS DAYS OF THE NOTICE OF THE CHARGEBACK, SURCHARGE, OR ACH REVERSAL. THE LAWYER MUST REIMBURSE THE ACCOUNT BEFORE MAKING ANY ADDITIONAL WITHDRAWALS.

SCR 20:1.15(b)(6) and WISCONSIN COMMENT

ADVANCED LEGAL FEES NOT SUBJECT TO THE ALTERNATIVE PROTECTION PROVISIONS OF SCR 20:1.5(g) AND ADVANCED COSTS THAT ARE PAID BY CREDIT CARD OR ELECTRONIC FUNDS TRANSFER MAY BE TEMPORARILY DEPOSITED INTO THE BUSINESS ACCOUNT AND TRANSFERRED PROMPTLY WITHIN TWO BUSINESS DAYS TO THE TRUST ACCOUNT.

PROHIBITED TRANSACTIONS TO AND FROM A TRUST ACCOUNT: SCR 20:1.15(f)(2)a.- b.

CASH

WITHDRAWALS OF CASH FROM A TRUST ACCOUNT OR FROM A DEPOSIT TO A TRUST ACCOUNT ARE PROHIBITED. CHECKS MADE PAYABLE TO "CASH" ARE PROHIBITED. WITHDRAWALS FROM A TRUST ACCOUNT BY AUTOMATED TELLER OR CASH DISPENSING MACHINE ARE PROHIBITED.

TELEPHONE TRANSFERS

DEPOSITS TO OR DISBURSEMENTS FROM A POOLED TRUST ACCOUNT BY TELEPHONE TRANSFERS ARE PROHIBITED. WIRE TRANSFERS MAY BE INITIATED BY TELEPHONE. TELEPHONE TRANSFERS MAY BE MADE BETWEEN NON-POOLED TRUST ACCOUNTS THAT A LAWYER MAINTAINS FOR A PARTICULAR CLIENT.

EFFECTIVE JULY 1, 2023

STATE BAR OF WISCONSIN

ETHICS Aviva Kaiser, Ethics Counsel

Under SCR 20:1.15(f)(1), just as every paper check, wire transfer, or deposit must be authorized by a lawyer or someone under the direct supervision of a lawyer, each electronic deposit or disbursement must also be authorized by the lawyer or someone under the direct supervision of a lawyer.

Ideally, lawyers should maintain with their trust account records a written record of such authorization, be it in the fee agreement, a written receipt, or other written document.

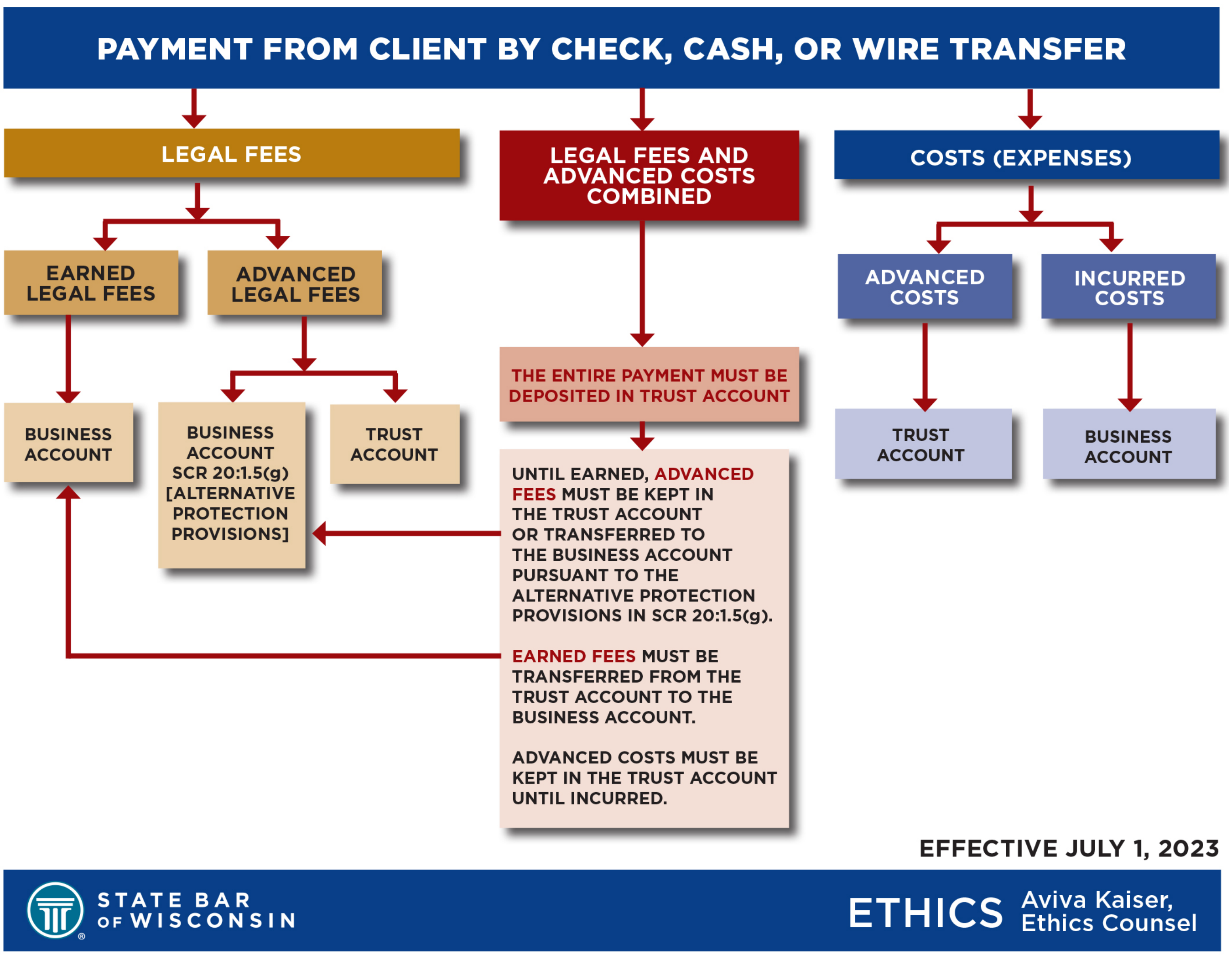
As additional security, just as with All-in-One Trust Accounts, within three business days of receiving actual notice of a chargeback, surcharge, or ACH reversal by a financial institution or card issuer, the lawyer must reimburse the trust account for any shortfall or negative balance caused thereby. The lawyer must do so before disbursing any other funds from the trust account.

To avoid any unexpected shortfalls, lawyers should consider working with their card processing provider or other electronic payments processing service to ensure that all fees, reversals, and chargebacks are deducted from an account other than the trust account, such as the operating account.

Beginning in 2007, lawyers could accept electronic payments into certain trust accounts under certain conditions. With some electronic payments, such as credit cards, costs in the form of transaction charges are often associated with such payments. Prior versions of SCR 20:1.15 (and SCR 20:1.5) did not clarify whether lawyers may hold a client responsible for such charges.

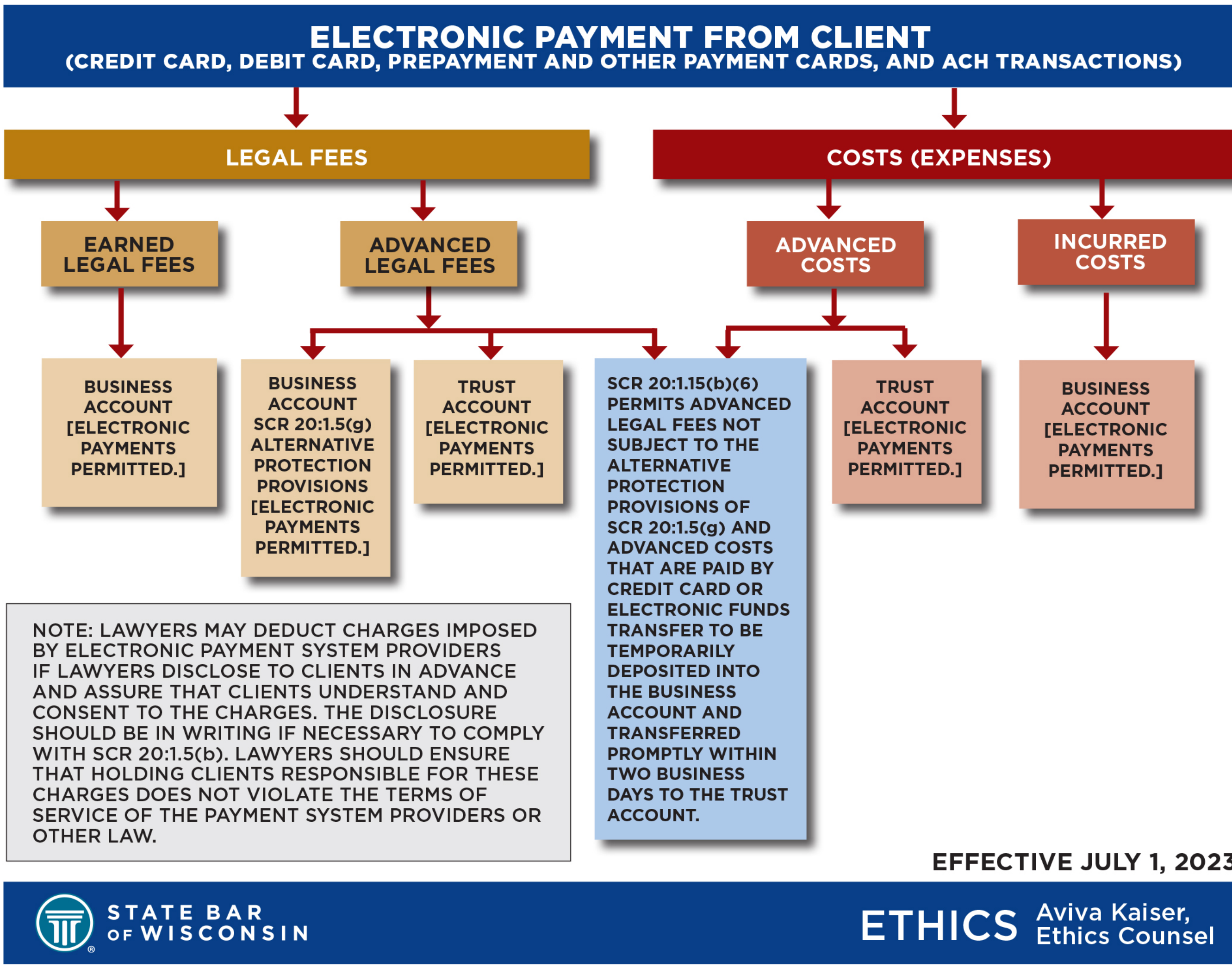
The 2023 comment to SCR 20:1.15(f)(1) clarifies that lawyers may hold clients responsible for these charges, provided that they disclose the practice to clients in advance and the client consents to the charges. The 2023 comment reads:

> "**Costs associated with electronic payments**
>
> "Electronic payment systems, such as credit cards, routinely impose charges on vendors when a customer pays for goods or services. That charge may be deducted directly from the customer's payment. Vendors who accept credit cards routinely credit the customer with the full amount of the payment and absorb the charges. Before holding a client responsible for these charges, a lawyer should disclose this practice to the client in advance, and assure that the client understands and consents to the charges. This disclosure should be in writing if necessary to comply with SCR 20:1.5(b). In addition, the lawyer should ensure that holding the client responsible for transaction costs does not violate the terms of service of the payment system provider or other law."



If the lawyer intends to make the client responsible for any portion of the service fees or charges associated with electronic transactions, such fees or charges become part of "the basis or rate of the fee and expenses for which the client will be responsible" under SCR 20:1.5(b)(1). Accordingly, the lawyer must provide advance written notice, preferably in the fee agreement, and obtain the client's consent before doing so.

The final sentence of this comment cautions lawyers to confirm that passing on any service fees or charges to the client is permissible under the lawyer's electronic payment processor agreement, as well as with any applicable federal, state, or local laws.



What Becomes of E-Banking Trust Account and All-in-One Trust Account?

The repeal of SCR 20:1.15(f)(3) also repeals those provisions relating to the E-Banking Trust Account and the All-in-One Trust Account. The revisions to the rule are permissive in nature. Lawyers and law firms that already have either of these two accounts may still use them. Electronic transactions are now allowed in any trust account, including existing E-Banking Trust Accounts and All-in-One Trust Accounts.

In the case of an existing E-Banking Trust Account, if a lawyer or law firm is satisfied having two trust accounts, one serving as their primary trust account and one as a "pass through" account for accepting and making electronic transactions, they may continue to do so. However, the lawyer or law firm also may close their E-Banking Trust Account and move to one single trust account.

With respect to an All-in-One Trust Account, this account should already be the lawyer's primary trust account. Lawyers may continue to use it for all transactions, electronic or otherwise. Upon the repeal of SCR 20:1.15(f)(3)c., however, the extra security requirements for the All-in-One Trust Accounts are also repealed (though lawyers will be responsible for reversals, chargebacks, and fees, pursuant to amended SCR 20:1.15(f)(1), discussed above). The practical effect is that lawyers will no longer be required to maintain a crime insurance policy or bond to engage in electronic transactions. Regardless of which account a lawyer chooses to use, they should continue to maintain reasonable account security for electronic transactions and record in the financial institution's electronic payment system the date, amount, payee, client matter, and reason for any deposit or disbursement.

Newly Created SCR 1.15(b)(6) and Its Implications

The amended trust account rule creates new subsection, SCR 20:1.15(b)(6), which provides as follows:

> "Advanced legal fees and costs. A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred, except as follows:
>
> "a. The lawyer complies with the requirements of SCR 20:1.5(g).
>
> "b. The lawyer may accept credit card payments or electronic funds transfer payments of advanced legal fees and expenses as temporary deposits in a non-trust account, so long as such funds are transferred promptly, and no later than two business days following receipt, into a client trust account. However, except as provided by SCR 20:1.5(g), a lawyer shall not accept any advance payment into a non-trust account if the lawyer has any reason to suspect that the funds will not be successfully transferred into the client trust account within two business day of receipt."

The implications of this new subsection are twofold. First, the 2016 version of SCR 20:1.15 made no reference to the SCR 20:1.5(g) alternative protection for advanced fees within the trust account rule. SCR 20:1.15(b)(6)a. rectifies this and clarifies that all advance payments for fees and costs must be held in the trust account until earned or incurred, unless the lawyer complies with the alternative protection for advanced fees under SCR 20:1.5(g).

Second, SCR 20:1.15(b)(6)b. creates a new option for lawyers to accept electronic payments for advanced fees and advanced costs into an operating account temporarily, so long as such funds are promptly transferred to the trust account within two business days following receipt. If the lawyer has any reason to suspect the funds will not be transferred to the trust account within two business days of receipt, then the lawyer shall not accept the electronic payment into the non-trust account.

This option allows lawyers to avoid the potential costs associated with maintaining two card processing services, one for the operating account and another for the trust account.

Instead, lawyers using SCR 20:1.15(b)(6)b. may maintain just one card processing service and have it attached to the operating account. Lawyers may use the operating account to accept electronic payments for advanced fees and costs, provided the funds are transferred to the trust account within two business days.

Under SCR 20: 1.15(b)(6)b., the operating account is used solely as a means to accept an electronic payment. The funds must still be held in trust. Because the primary duty under SCR 20:1.15(b)(1) to hold in trust client and third party funds persists, any payments received electronically must be moved to the trust account and held there until such time as the fees are earned or the costs incurred.

This option should provide more flexibility for firms and sole practitioners to be able to use modern electronic banking methods, while minimizing the costs of doing so. In addition, using SCR 20:1.15(b)(6)b. will insulate the trust account from potential reversals, chargebacks, or other unexpected fees that may arise.

Tax Considerations for Electronic Transactions

Lawyers who choose to accept electronic payments should consider tax consequences. For example, 26 U.S.C. § 6050W requires credit card processors to report gross credit card transactions to the IRS on a Form 1099-K. This law does not distinguish payments made to an operating account from payments made to an IOLTA account. Payments for advanced fees and costs are reported together with payments for services already rendered. Therefore, amounts reported on the Form 1099-K will not necessarily reflect gross income actually received.

Further, 26 U.S.C. § 6050W imposes a 28% withholding penalty on all credit card transactions if the name of the lawyer or law firm used by the card processor does not exactly match the name associated with the federal employment identification number.

In light of these and other potential tax implications, lawyers should consider consulting a tax professional before accepting electronic payments.

Amendments to Other Rules and Comments

In addition to the changes to the rules regarding electronic transactions, the Wisconsin Supreme Court adopted other minor amendments as discussed below.

The court amended SCR 20:1.0(dm), the definition of "flat fee," by adding a single sentence (underlined) to the definition:

> "(dm) 'Flat fee' denotes a fixed amount paid to a lawyer for specific, agreed-upon services, or for a fixed, agreed-upon stage in a representation, regardless of the time required of the lawyer to perform the service or reach the agreed-upon stage in the representation. A flat fee, sometimes referred to as 'unit billing,' is not an advance against the lawyer's hourly rate and may not be billed against at an hourly rate. Flat fees become the property of the lawyer upon receipt and are subject to the requirements of SCR 20:1.5, including SCR 20:1.5(f) or (g) and SCR 20:1.5(h), SCR 20:1.15(f)(3)b.4., and SCR 20:1.16(d). <u>Notwithstanding that lawyers have a property interest upon receipt of flat fees, such fees can be earned only by the provision of legal services</u>."

This sentence does not alter the definition, but clarifies the rule.

The statement that "flat fees become the property of the lawyer upon receipt" occasionally led lawyers to mistakenly believe that flat fees are earned upon receipt. The only way fees may be earned is by providing legal services for which the fee represents payment, and unearned fees in the lawyer's possession must be refunded upon termination of the representation. See SCR 20:1.16(d).

This new sentence clarifies that a lawyer who receives an advanced flat fee must earn the fee by providing legal services. If the representation is terminated before completion, the lawyer must refund the unearned portion.

The court amended SCR 20:1.15(b)(1), again by the addition of a single sentence (underlined):

> "**Separate account**. A lawyer shall hold in trust, separate from the lawyer's own property, that property of clients and 3rd parties that is in the lawyer's possession in connection with a representation. All funds of clients and 3rd parties paid to a lawyer or law firm in connection with a representation shall be deposited in one or more identifiable trust accounts. <u>Except as provided by sub. (b)(3), a lawyer shall not hold any funds in a trust account that are unrelated to a representation</u>."

This sentence clarifies lawyers are not permitted to use their trust accounts for purposes other than the representation of clients, such as for the lawyer's own purposes or to "hold" funds for a non-client friend or associate.

SCR 20:1.15(b)(3) prohibits lawyers from holding their own funds in a trust account except for nominal amounts to cover account services fees. Holding funds unrelated to a representation is generally prohibited by other rules, such as SCR 20:8.4(c). Thus, under prior versions of the rule, lawyers had to look elsewhere for a clear statement that a trust account is to be used only in connection with the representation of the firm's clients.

The court also added a comment to SCR 20:1.15(j) to clarify that Wisconsin-licensed lawyers who practice in another jurisdiction may use a trust account that is compliant with the rules of that jurisdiction for Wisconsin matters:

> “This rule does not prohibit a lawyer whose principal office is in another jurisdiction and who permissibly represents clients in Wisconsin matters from using a trust account for Wisconsin matters that is compliant with the rules of the other jurisdiction.”

Again, this is not a substantive change from the prior rule, but serves to clarify the language of the rule.

The 2016 Rule prohibited credit, debit, and other card payments in fiduciary accounts under SCR 20:1.15(k)(5)b., as well as cash transactions in fiduciary accounts under SCR 20:1.15(k)(5)a. The court deleted SCR 20:1.15(k)(5)b. and amended SCR 20:1.15(k)(5) to provide in its entirety:

> “(5) **Cash transactions prohibited.**
>
> “No withdrawal of cash shall be made from a fiduciary account or from a deposit to a fiduciary account. No check shall be made payable to ‘Cash.’ No withdrawal shall be made from a fiduciary account by automated teller or cash dispensing machine.”

Just as the 2023 Rule permits electronic transactions in trust accounts, the 2023 Rule also permits electronic transactions, including card payments, in fiduciary accounts governed by SCR 20:1.15(k).

Conclusion

In sum, the amendments to the rules effective **July 1, 2023**, clarify existing duties relating to safekeeping client and third party funds and provide options for Wisconsin lawyers to use modern electronic banking transactions in the manner that best suits their needs.

WBA wishes to thank Atty. Aviva Meridian Kaiser and Atty. Timothy J. Pierce, both with the Wisconsin State Bar, and Atty. Travis J. Stieren, with the Office of Lawyer Regulation, for writing the article and allowing WBA to reprint the article.

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Wisconsin Bankers Association

Compliance Journal

May 2023

Special Focus

Recent Agency Guidance Reflect Upcoming Examination Focus

Over the past several weeks, agencies have released guidance that identifies activities which are expected to be the focus of upcoming compliance examinations. Compliance officers need know how each guidance may impact their institution in anticipation of examiner questions and review.

Each guidance relates to activities the respective federal banking regulatory agency believes violate Section 1036(a)(1)(B) of the Dodd-Frank Act (Dodd-Frank UDAAP) and Section 5 of the Federal Trade Commission Act (FTC UDAP), which prohibits unfair or deceptive acts or practices (UDAP). The agencies use the same standards in determining whether the identified act or practice is unfair under the respective statutes. In particular, an act or practice is unfair when it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition.

In each guidance, the agencies provide their analysis of how the identified acts are unfair, how the components of Dodd-Frank UDAAP and FTC UDAP are met, and what financial institutions should consider to avoid a potential UDAAP/UDAP violation.

FDIC: Supervisory Guidance on Charging Overdraft Fees for Authorize Positive, Settle Negative Transactions

On April 26, 2023, the Federal Deposit Insurance Corporation (FDIC) issued guidance to ensure that supervised institutions are aware of the consumer compliance risks associated with charging an overdraft fee on a transaction that was authorized against a positive balance but settled against a negative balance, a practice FDIC refers to as "authorize positive, settle negative" (APSN). FDIC previously identified concerns with APSN in its June 2019 *Consumer Compliance Supervisory Highlights*. The guidance expands on the 2019 Supervisory Highlights article by discussing FDIC's concerns with both the available and ledger balance methods used by financial institutions when assessing overdraft fees. The guidance also clarifies that disclosures describing transaction processing may not mitigate the concerns.

Background

FDIC recognizes that overdraft programs, transaction clearing, and settlement processes are complex. In the case of APSN transactions, which involve consumers being assessed overdraft fees for transactions where they had sufficient account balances at the time the transactions were initiated, it may not be possible for consumers to determine when fees will be assessed and how they may be avoided.

Financial institutions' processing systems generally use either a ledger balance method or an available balance method, including for the purpose of assessing overdraft-related fees. A ledger balance method calculates the account balance based only on transactions settled during the relevant period and does not take into account authorization holds. The method typically correlates to the balance reflected on a consumer's periodic statement.

An available balance method calculates the account balance based on authorized (but not settled) transactions the financial institution is obligated to pay under contractual or other obligations, as well as settled transactions and pending deposits. The available balance is generally the amount of money/funds the consumer can access because it accounts for any pending debit or credit transactions. The balance typically correlates to the balance accessible to consumers online, through a mobile application, at an ATM, or by phone. An account's available balance may be impacted by pending debit transactions. This type of authorization hold is sometimes referred to as a debit hold, a temporary debit authorization hold, or a preauthorization.

Some financial institutions assess overdraft fees on debit card transactions that authorize when a customer's available balance is positive but later post to a customer's account when their balance is negative. In this scenario, a customer's account has a sufficient available balance to cover a debit card transaction when the transaction is authorized but, due to one or more intervening transactions, has an insufficient balance to cover the transaction at the time it settles.

In addition to assessing an overdraft fee on the APSN transaction, some financial institutions also assess overdraft fees on intervening transactions that exceed the customer's account balance. In this scenario, for example, the institution reduces a customer's balance to account for the initial authorized debit card transaction, and subsequently, an intervening transaction further reduces the customer's available balance so that the account no longer has a sufficient balance. The financial institution charges an overdraft fee on both the intervening transaction and the initial APSN transaction when posted to the customer's account.

Examination Findings and FDIC Determinations

During consumer compliance examinations, FDIC determined that certain overdraft practices related to APSN transactions were unfair. As a result of its determination, FDIC has taken the position that the failure of a financial institution to take steps to avoid assessing overdraft-related fees when transactions are authorized on positive balances but settle on negative balances results in heightened risks of violations of Dodd-Frank UDAAP and FTC UDAP.

Unanticipated and unavoidable overdraft fees can cause substantial injury to consumers. A consumer is likely to suffer injury when charged more overdraft fees than may have been anticipated based on the consumer's actual spending. While not all overdraft fees may be attributable to APSN transactions, the likely presence of intervening transactions may cause additional injury. The consumer cannot reasonably avoid the injury because the consumer does not have the ability to effectively control payment systems and overdraft processing systems practices. Due to the complicated nature of overdraft processing systems and payment system complexities outside the consumer's control, consumers may be unable to avoid injury.

Additionally, in some cases, the institutions' methodology for assessing overdraft fees on APSN transactions resulted in unanticipated and unavoidable overdraft fees that were not outweighed by a countervailing benefit to consumers or competition. Dodd-Frank UDAAP and FTC UDAP risks exist in both available balance and ledger balance methods of assessing overdraft fees, but may be more pronounced in situations where institutions use available balance methods. For example, the use of available balance to assess overdraft fees may exacerbate the injury, as temporary holds may lead to consumers being assessed multiple overdraft fees when they may have reasonably expected only one. FDIC encourages institutions to review their practices regarding the charging of overdraft fees on APSN transactions to ensure customers are not charged overdraft fees for transactions consumers may not anticipate or avoid.

FDIC also determined that third parties often play significant roles in processing transactions, identifying and tracking balances at the time of authorization, and providing systems that determine when overdraft fees are assessed. Institutions should ensure

May 2023
Volume 28, Number 12

Wisconsin Bankers Association
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overdraft programs provided by third parties are compliant with all applicable laws and regulations. FDIC emphasized that third-party arrangements may present risks if not properly managed by financial institution management. Institutions are encouraged to review third-party arrangements, as institutions are expected to maintain adequate oversight of third-party activities and appropriate quality control over products and services provided through third-party arrangements.

FDIC also encouraged financial institutions to review and understand the risks presented from third-party system settings for overdraft-related fees, as well as understand the capabilities of their core processing system(s), such as identifying and tracking transactions authorized on a positive balance but settled on a negative balance and maintaining data on such transactions. Some third parties offer data processing system enhancements aimed at preventing overdraft-related fees from being charged for a transaction when a debit hold authorizes against a positive balance. Note that some third parties may offer these enhancements as optional or require client financial institutions to take action in order to implement them.

Lastly, FDIC also generally encourages financial institutions to review disclosures and account agreements to ensure the institution's practices for charging any fees on deposit accounts are communicated accurately, clearly, and consistently. However, FDIC cautioned that disclosures generally do not fully address Dodd-Frank UDAAP and FTC UDAP risks associated with APSN transactions and related overdraft fees.

Consumer Financial Protection Circular 2023-02: Reopening Deposit Accounts that Consumers Previously Closed

On May 10, 2023, the Bureau of Consumer Financial Protection (CFPB) released guidance which provides that if a financial institution unilaterally reopens a deposit account a consumer has closed to process a debit or deposit (*i.e.*, withdrawal, ACH transaction, check), that action can constitute an unfair act or practice under the Consumer Financial Protection Act (CFPA). CFPB believes such action may impose substantial injury on consumers that they cannot reasonably avoid and that is not outweighed by countervailing benefits to consumers or competition.

Background

As compliance officers know, consumers may elect to close a deposit account for a variety of reasons. The process of closing a deposit account often takes time and effort. For example, closing an account involves taking steps to bring the account balance to zero at closure. Typically, the financial institution returns any funds remaining in the account to the consumer at closure and the consumer typically must pay any negative balance at closure.

Some institutions require customers to provide a certain period of notice (*e.g.*, a week) prior to closing the account to provide time for the financial institution to process any pending debits or deposits. Deposit account agreements typically indicate that the financial institution may return any debits or deposits to the account that the financial institution receives after closures and faces no liability for failing to honor any debits or deposits received after closure.

Examination Findings and CFPB Determinations

CFPB found that sometimes after a consumer completes all of the steps that the financial institution requires to initiate the process of closing a deposit account and the financial institution completes the request, the financial institution unilaterally reopens the closed account if it receives a debit or deposit to the closed account. CFPB found that some financial institutions may reopen an account even if doing so would overdraw the account, causing the financial institution to impose overdraft or non-sufficient funds (NSF) fees. Financial institutions may also charge account maintenance fees upon reopening, even if the consumers were not required to pay such fees prior to account closure (*e.g.*, because the account previously qualified to have the fees waived).

Compliance officers should be aware that CFPB has brought an enforcement action regarding the practice of account reopening under CFPA's prohibition against UDAP. CFPB found that a financial institution engaged in an unfair practice by reopening deposit accounts consumers had previously closed without seeking prior authorization or providing timely notice. The practice of reopening closed deposit accounts caused some account balances to become negative and potentially subjected consumers to various fees, including overdraft and NSF fees. In addition, when the financial institution reopened an account to process a deposit, creditors had the opportunity to initiate debits to the accounts and draw down the funds, possibly resulting in a negative balance and the accumulation of fees.

In the guidance, CFPB provided its analysis of how the unilateral reopening of deposit accounts previously closed by consumers can constitute a violation of CFPA's prohibition on unfair acts or practices.

After a consumer has closed a deposit account, a financial institution's act of unilaterally reopening that account upon receiving a debit or deposit may cause monetary harm to the consumer. The charge may be in the form of an account activity charge, overdraft or NSF fee, or for not maintaining a minimum balance. Other substantial injury could include reporting negative information to a consumer reporting agency if the reopened account becomes overdrawn as a result of the processing of a debit after account closure.

In its analysis, CFPB found that consumers often cannot reasonably avoid the risk of substantial injury caused by financial institutions' practice of unilaterally reopening accounts that consumers previously closed because they cannot control one or more of the following circumstances: a third party's attempt to debit or deposit money, the process and timing of account closure, or the terms of the deposit account agreements.

To the extent financial institutions are concerned about controlling their own costs to remain competitive, CFPB believes institutions have alternatives to reopening a closed account upon receiving a debit or deposit that could minimize their expenses and liability. For example, the financial institution could decline any transactions that they receive for accounts consumers previously closed. In addition to minimizing the institution's costs, not reopening the accounts may protect the financial institution against the use of closed accounts to commit fraud.

CFPB has instructed in its guidance that government enforcers (*e.g.*, banking regulators) should consider whether a financial institution has violated the prohibition against unfair acts or practices in CFPA if it is discovered that a financial institution has unilaterally reopened accounts that consumers previously closed.

OCC Bulletin 2023-12: Overdraft Protection Programs Risk Management Practices

On April 26, 2023, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2023-12 Overdraft Protection Programs: Risk Management Practices to address the risks associated with bank overdraft protection programs. The guidance provides background information on overdraft protection programs and identifies certain practices that may result in heightened risk exposure. The practices include assessing overdraft fees on "authorize positive, settle negative" transactions (APSN) as identified in CFPB's guidance outlined directly above and assessing a fee each time an item is presented for payment after it was returned for non-sufficient funds (representment fees). The guidance also describes several practices that may help banks control risks associated with overdraft protection programs, as well as compliance with FTC UDAP.

OCC's guidance also identified that high limits or lack of daily limits on the number of fees assessed to an account can heighten risks to financial institutions of UDAP. OCC stated that in its supervisory experience, charging overdraft or NSF fees with a high limit (or without limit) for multiple transactions in a single day has contributed to determinations that bank's overdraft protection programs as a whole were unfair for purposes of FTC UDAP because the lack of limits resulted in high costs for consumers and the difficulty in bringing accounts positive.

Additionally, OCC identified that sustained overdraft fees can heighten UDAP risks. OCC has identified that charging a fixed, periodic fee for the failure to cure a previous overdrawn balance has contributed to findings of unfairness and deception under FTC UDAP when the bank does not accurately disclose the circumstances under which the consumer could incur sustained overdraft fees. The fees make it more difficult for customers facing liquidity challenges to reasonably avoid the fees by bringing the account balance positive.

OCC outlines several mitigation steps including that financial institutions should have processes in place to manage the risks associated with offering new, modified, or expanded products or services, including new overdraft protection programs or changes to existing programs. Financial institutions' processes and control systems should align with established policies and incorporate appropriate procedures and practices for managing risks associated with overdraft programs.

Conclusion

Through recent releases, FDIC, CFPB, and OCC identified activities each believe violate Dodd-Frank UDAAP and FTC UDAP having concluded the acts are unfair because the acts caused or are likely to cause substantial injury to consumers, cannot be reasonably avoided by consumers, and are not outweighed by countervailing benefits to consumers or to competition..

Given the instructions within each guidance, compliance officers should review their respective practices to determine whether activities discussed within the guidance are practices the institution permits.

Compliance officers should also work with their core processors and other third-party vendors to know how systems functionality can best be used to prevent the identified activity from occurring. For example, compliance officers and deposit operations should work with their core processor to ensure that once an account is closed by the consumer that the account cannot be reopened by a posting of a transaction to the closed account. Often financial institutions monitor account activity when an account is closed due to a consumer reporting fraud occurring on an account to ensure items do not post to the account. Deposit operations should ensure a similar level of monitoring occurs when an account is closed at the request of a consumer in a non-fraud related situation to protect against the closed account being reopened. Also, to work with core processors and other third-party vendors to identify which transactions were approved when the consumer had a positive balance to ensure that if the balance is negative when the previously approved transaction posts to the account, the account is not charged an overdraft or NSF fee.

Compliance officers should expect compliance examiners to question how the financial institution monitors or prevents the activities identified in the guidance, as applicable.

The FDIC Supervisory Guidance may be viewed at:
www.fdic.gov/news/financial-institution-letters/2023/fil23019a.pdf

The CFPB Compliance Circular 2023-02 may be viewed at: www.consumerfinance.gov/compliance/circulars/consumer-financial-protection-circular-2023-02-reopening-deposit-accounts-that-consumers-previously-closed/

The OCC Bulletin 2023-12 may be viewed at: https://www.occ.gov/news-issuances/news-releases/2023/nr-occ-2023-41.html

Joint Agency Statement and Interim Final Rule to Facilitate Transition from US LIBOR

As financial institutions continue to move towards completing steps to transition away from the use of U.S. dollar (USD) London Inter-Bank Offered Rate (LIBOR) in contracts, state and federal banking regulators remind institutions of the importance to complete such steps by the end of June. The agencies released an interagency statement and an interim final rule to further facilitate the efforts. Both items are summarized below.

Interagency Statement on Completing the LIBOR Transition

The Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), National Credit Union Administration (NCUA), and Bureau of Consumer Financial Protection (CFPB), in conjunction with the state bank and state credit union regulators (collectively, agencies) issued a joint statement to remind supervised institutions that USD LIBOR panels will end on **06/30/2023**. The agencies also reiterated their expectations that institutions with USD LIBOR exposure should complete their transition of remaining LIBOR contracts as soon as practicable. As noted in prior interagency statements, failure to adequately prepare for LIBOR's discontinuance could undermine financial stability and financial institutions' safety and soundness and create litigation, operational, and consumer protection risks.

The agencies stated each expect institutions to have taken all necessary steps to prepare for an orderly transition away from LIBOR by the end of June. The agencies also stated that while financial institutions have reported significant progress in their LIBOR transition efforts, work remains for financial institutions to prepare for the end of the USD LIBOR panels. The agencies encourage institutions to ensure that replacement alternative rates are negotiated where needed and in place in advance of June 30th, for all LIBOR-referencing financial contracts including investments, derivatives, and loans. The agencies also encourage institutions to work expeditiously with their customers and coordinate with other institutions as needed in these efforts.

The interagency statement may be viewed at: www.fdic.gov/news/financial-institution-letters/2023/fil23020.html

Interim Final Rule: Facilitating the LIBOR Transition Consistent with the LIBOR Act (Regulation Z)

The Bureau of Consumer Financial Protection (CFPB) issued an interim final rule to amend Regulation Z, which implements the Truth in Lending Act (TILA), to reflect the enactment of the Adjustable Interest Rate (LIBOR) Act (the LIBOR Act) and its implementing regulation promulgated by the Board of Governors of the Federal Reserve System (FRB).

The interim final rule further addresses the planned cessation of most USD LIBOR tenors after **06/30/2023**, by incorporating the FRB-selected benchmark replacement for consumer loans into Regulation Z. The interim final rule conforms the terminology from the LIBOR Act and FRB's implementing regulation into relevant Regulation Z open-end and closed-end credit provisions and also addresses treatment of the 12-month USD LIBOR index and its replacement index, including permitting creditors to use alternative language in change-in-terms notice content requirements for situations where the 12-month tenor of the LIBOR index is being replaced consistent with the LIBOR Act. The interim final rule is effective **05/15/2023**.

As there have been several rules regarding the sunset of USD LIBOR, the following is a recap of past actions to help explain the rationale for the issuance of the latest interim final rule.

Background

Introduced in the 1980s, LIBOR was intended to measure the average rate at which a financial institution could obtain unsecured funding in the London interbank market for a given period, in a given currency. In the United States, financial institutions have used LIBOR as a common benchmark rate for a variety of adjustable-rate consumer financial products, including mortgages, credit cards, home equity lines of credit (HELOCs), reverse mortgages, 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 12-month USD LIBOR plus two percentage points. LIBOR is set to expire on **06/30/2023**.

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.

On 12/08/2021, CFPB issued the 2021 LIBOR Transition Final Rule generally to address the expected discontinuance of most USD tenors of LIBOR in June 2023. The 2021 LIBOR Transition Final Rule, among other things, amended open-end and closed-end provisions of Regulation Z to provide examples of replacement indices to USD LIBOR tenors that meet certain Regulation Z standards. For each of the open-end and closed-end provisions, while CFPB generally provided examples of certain indices, including Secured Overnight Financing Rate (SOFR)-based replacement indices for 1-month, 3- month, and 6-month tenors of USD LIBOR, CFPB reserved judgment about whether to include a SOFR-based replacement index for the 1-year (now being referred to as 12-month in the interim final rule) USD LIBOR index until it obtained additional information.

CFPB stated that once it knew which SOFR-based index the Alternative Reference Rate Committee (ARRC) would recommend to replace the 12-month USD LIBOR index for consumer products, CFPB would consider determining whether the replacement index and replacement margin met the appropriate standards in Regulation Z and would then consider whether to codify that determination in a supplemental final rule, or otherwise announce that determination. Most provisions of the 2021 LIBOR Transition Final Rule were effective on 04/01/2022.

On 03/15/2022, Congress enacted the LIBOR Act. Among other things, the LIBOR Act provides that FRB may identify a replacement index based on SOFR published by the Federal Reserve Bank of New York (or a successor administrator), including tenor spread adjustments, to replace the 1-month, 3-month, 6-month, and 12-month tenors of USD LIBOR for any LIBOR contracts that do not otherwise specify a replacement rate fallback provision or method for selecting a fallback rate.

The LIBOR Act (and FRB's subsequent final rule, discussed below) identify the replacement indices as the "FRB-selected benchmark replacement" index. The LIBOR Act provides certain safe harbors for use of an FRB-selected benchmark replacement for consumer loans, including stating that the FRB-selected benchmark replacements constitute replacement indices that have historical fluctuations that are substantially similar to those of LIBOR for purposes of TILA and regulations promulgated under that statute.

FRB issued a final rule to implement the LIBOR Act on 12/16/2022, effective 02/27/2023 (FRB's 2022 LIBOR Act Final Rule). Among other things, FRB's final rule established benchmark replacements for contracts governed by U.S. law that reference certain tenors of USD LIBOR, including those of 1-month, 3-month, 6-month, 11 and 12-month tenors, that do not have terms that provide for the use of a clearly defined and practicable replacement benchmark rate following the cessation of LIBOR.

The LIBOR Act, and FRB's implementing regulation, provide for certain adjustments in general for LIBOR contracts and more specifically for LIBOR contracts that are consumer loans. Consistent with LIBOR Act, the final rule identified each of those indices as a "FRB-selected benchmark replacement" for consumer loans, thereby meeting the safe harbor criteria in the LIBOR Act. The final rule provided that the FRB-selected benchmark replacements for LIBOR contracts that are consumer loans using 1-month, 3-month, 6-month, or 12-month tenors of USD LIBOR during the one-year period beginning on the LIBOR replacement date shall be the corresponding 1-month, 3-month, 6-month, or 12-month CME Term SOFR plus an amount that transitions linearly for each business day during that period from the difference between the relevant CME Term SOFR and the relevant LIBOR tenor determined as of the day immediately before the LIBOR replacement date to the applicable tenor spread adjustment identified in the final rule. After expiration of that first-year period, the rule provided that the FRB-selected benchmark replacements shall be the corresponding 1-month, 3-month, 6-month, or 12-month CME Term SOFR plus the applicable tenor spread adjustment identified in the final rule. Effectively, the FRB-selected benchmark replacements for LIBOR contracts that are consumer loans as set forth in the FRB's final rule are the indices based on SOFR recommended by the ARRC for consumer products for the 1-month, 3-month, 6-month and 12-month USD LIBOR tenors.

Rationale for Interim Final Rule

CFPB issued the interim final rule to amend Regulation Z for both open-end and closed-end credit to make changes consistent with the LIBOR Act and its implementing regulation issued by FRB and further address the planned cessation of LIBOR. The changes amend and update CFPB's Facilitating the LIBOR Transition (Regulation Z) final rule published in the *Federal Register* on 12/08/2021 (2021 LIBOR Transition Final Rule).

In general, the interim final rule makes several conforming terminology changes to align with the LIBOR Act and FRB's implementing regulation. As mentioned above, in the 2021 LIBOR Transition Final Rule, CFPB generally had provided examples of certain indices, including spread-adjusted SOFR-based indices, that may meet the applicable Regulation Z standards (referred to hereafter as SOFR-based replacement indices) for the 1-month, 3-month, and 6-month tenors of USD LIBOR, but it reserved judgment about whether to include references to a 1-year (or 12-month) USD LIBOR index and its SOFR based replacement index.

CFPB is now also conforming Regulation Z with the LIBOR Act and FRB's implementing regulation by adding such references with respect to the SOFR-based replacement for the 12-month tenor of LIBOR. The interim final rule does not alter or modify FRB's determination in the 2021 LIBOR Transition Final Rule in relation to the prime rate as a replacement index.

<u>Open-End Credit</u>
CFPB amended several open-end credit provisions in Regulation Z. First, CFPB has changed the terminology used in the 2021 LIBOR Transition Final Rule to make it consistent with terminology in the LIBOR Act and FRB's implementing regulation. Specifically, CFPB has replaced all references to the "index based on SOFR recommended by the Alternative

Reference Rates Committee for consumer products" with "the FRB-selected benchmark replacement for consumer loans" and adding a new definition for that term in §1026.2(a)(28). For the new definition and throughout the interim final rule, CFPB uses the term 12-month tenor instead of the 1-year tenor with respect to the USD LIBOR index to align with the terminology used in the LIBOR Act and FRB's implementing regulation. The changes are set forth in §1026.40(f)(3)(ii) and related comments for HELOCs and in §1026.55(b)(7) and related comments for credit card accounts.

Second, CFPB revised Regulation Z interpretations to incorporate the FRB-selected benchmark replacement for consumer loans to replace the 12-month LIBOR index, as prescribed by the LIBOR Act and FRB's implementing regulation, as an index that has historical fluctuations that are substantially similar to those of the 12-month USD LIBOR index it is intended to replace. Consistent with the LIBOR Act and FRB's implementing regulation, CFPB's prior determination of the spread-adjusted indices based on SOFR recommended by ARRC is obsolete given that "the FRB-selected benchmark replacement for consumer loans" to replace 1-month, 3-month, and 6-month USD LIBOR indices is the same as the corresponding spread-adjusted index based on SOFR recommended by the ARRC for consumer products. The changes are set forth in §1026.40(f)(3)(ii) and related comments for HELOCs and in §1026.55(b)(7) and related comments for credit card accounts.

Third, CFPB added the FRB-selected benchmark replacement for consumer loans that would replace the 12-month USD LIBOR index to the list of indices where a creditor is allowed to use an alternative method to disclose information about the periodic rate and annual percentage rate (APR) in change-in-terms notices for HELOCs and credit card accounts as a result of the replacement of the LIBOR index in certain circumstances. The changes are set forth in comment 9(c)(1)-4 for HELOCs and in comment 9(c)(2)(iv)-2.ii for credit card accounts.

Fourth, CFPB added the FRB-selected benchmark replacement for consumer loans that would replace the 12-month USD LIBOR index to the list of indices where a card issuer is allowed to use an alternative method for determining whether the card issuer can terminate its obligation under the credit card account rate reevaluation requirements where the rate applicable immediately prior to a rate increase was a variable rate calculated using a LIBOR index. CFPB also deleted its prior determination in Regulation Z interpretations given that "the FRB-selected benchmark replacement for consumer loans" to replace 1-month, 3-month, and 6-month USD LIBOR indices is the same as the corresponding spread-adjusted index based on SOFR recommended by the ARRC for consumer products. The changes are set forth in §1026.59(f)(3) and comment 59(f)-4.B.

Closed-End Credit

CFPB also amended the closed-end credit provisions in Regulation Z. First, CFPB changed the terminology used in its 2021 LIBOR Transition Final Rule to make it consistent with terminology in the LIBOR Act. Specifically, CFPB replaced the reference to the "index based on SOFR recommended by the Alternative Reference Rates Committee for consumer products" with a reference to "the FRB-selected benchmark replacement for consumer loans."

Second, CFPB revised an illustrative example in Regulation Z official interpretations to incorporate the FRB-selected benchmark replacement for consumer loans to replace the 12-month LIBOR index, as prescribed by the LIBOR Act, as an index that is comparable to the 12-month USD LIBOR index it is intended to replace for purposes of the closed-end refinancing provisions. The changes are set forth in comment 20(a)(3)-ii.B.

As stated above, CFPB's interim final rule is effective **05/15/2023**. Comments regarding the interim final rule are due **6/12/2023**. CFPB has also created a summary of the interim final rule and has updated its LIBOR Transition FAQs.

The interim final rule may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_facilitating-libor-transition-libor-act-regulation-z_2023-04.pdf

The rule summary may be viewed at: https://files.consumerfinance.gov/f/documents/cfpb_fast-facts_libor-transition-interim-final-rule.pdf

CFPB's LIBOR Transition FAQs may be viewed at: https://www.consumerfinance.gov/compliance/compliance-resources/other-applicable-requirements/libor-index-transition/libor-transition-faqs/

Wisconsin Bankers
ASSOCIATION

Compliance Journal
April 2023

Special Focus

It's Here . . . Final Section 1071 Rule

As expected, the Bureau of Consumer Financial Protection (CFPB) hit its end-of-March target date with the release of its final small business loan data collection and reporting rule. The final rule revises Regulation B, which implements the Equal Credit Opportunity Act (ECOA), to require the collection and reporting to CFPB of certain data on applications for credit by small businesses.

Compliance officers across Wisconsin are now shifting their efforts to more fully understand the requirements of the new rule and to creating implementation and training plans. To assist with beginning to understand the scope and general concepts of the final rule, below is a summary of the final rule.

Who Must Comply with the Rule

Covered Financial Institutions
Coverage of the rule is based upon the level of certain loan origination activity, not upon the asset size of a financial institution. The final rule applies to "covered financial institutions." A covered financial institution is one that originated at least 100 "covered credit transactions" for small businesses in each of the two preceding calendar years.

Covered Credit Transactions
Generally, a covered credit transaction is one that meets the definition of business credit under existing Regulation B section 1002.2(g), unless the credit is specifically excluded by the final rule. Business credit includes loans, lines of credit, credit cards, merchant cash advances, and agricultural-purpose credit.

The final rule excluded from the definition of covered credit transactions:

- Trade Credit
- HMDA-Reportable Transactions
- Insurance Premium Financing
- Public Utilities Credit
- Securities Credit
- Incidental Credit

The final rule also excludes factoring, leases, and consumer-purpose credit. A transaction qualifies as consumer-purpose credit if the financial institution offers or extends the credit primarily for personal, family, or household purposes. For example, an open-end credit account used for both personal and business/agricultural purposes is not business credit under Section 1071 unless the financial institution designated or intended for the primary purpose of the account to be business/agricultural-related.

For purposes of counting originations to determine whether the bank is a covered financial institution, transactions that extend, renew, or otherwise amend an existing transaction are not counted as originations even if they increase the credit line or credit amount of the existing transaction. A refinancing can be a counted as a covered origination. A refinancing occurs when an existing obligation is satisfied and replaced by a new obligation undertaken by the same borrower.

For example, if a financial institution originates 50 term loans and 30 lines of credit for small businesses in each of the preceding two calendar years, along with 25 line increases for small businesses in each of those years, the financial institution is not a covered financial institution because it has not originated at least 100 covered credit transactions in each of the two preceding calendar years.

Originated vs Application

For purposes of determining coverage of the final rule, Section 1071 focuses on counting the number of covered credit transactions originated. A financial institution qualifies as a covered financial institution based on total covered credit transactions originated for small businesses, rather than covered applications received from small businesses. For example, if in both 2024 and 2025, a financial institution that received 105 covered applications from small businesses and originated 95 covered credit transactions for small businesses, then for 2026, the financial institution is not a covered financial institution.

Preceding Calendar Years

Also, the definition of a covered financial institution refers to preceding calendar years. For example, in 2029, the two preceding calendar years are 2027 and 2028. Accordingly, in 2029, a financial institution does not meet the loan-volume threshold if it did not originate at least 100 covered credit transactions for small businesses both during 2027 and during 2028.

Small Business

The final Section 1071 defines “small business” to mean a business with gross annual revenue of $5 million or less for its preceding fiscal year.

When to Collect Section 1071 Data

Once a financial institution determines it is a covered financial institution under Section 1071, the institution will need to collect and report data related to any “covered application” from a small business. The data collected and reported applies to covered applications approved and denied; not just for those covered applications approved.

Covered Application

A covered application is an oral or written request for business credit covered by the rule (covered credit transaction) that is made in accordance with procedures used by the financial institution for the type of credit requested. The final rule gives some latitude to financial institutions to establish their own application procedures, including designating the type and amount of information it will require from an applicant.

The term “procedures” refers to the actual practice followed by the financial institution as well as its stated application procedures. For example, if a financial institution’s stated policy is to require all applications to be in writing on the financial institution’s application form, but the financial institution also makes credit decisions based on oral requests, the financial institution’s procedures are to accept both oral and written applications.

The final rule excludes reevaluations, extensions, or renewal requests on an existing business credit account, unless the request seeks additional credit amounts. The final rule also excludes inquiries and prequalification requests from the definition of covered application. However, an applicant’s request to refinance and to request additional credit amounts on an existing account both constitute covered applications.

The term “covered application” does not include solicitations, firm offers of credit, or other evaluations initiated by the financial institution because in these situations the business

April 2023
Volume 28, Number 11

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has not made a request for credit. For example, if a financial institution sends a firm offer of credit to a business for a $10,000 line of credit, and the business does not respond, it is not a covered application because the business never made a request for credit. However, using the same example, if the business seeks to obtain the credit offered, assuming the requirements of a covered application are otherwise met, the business' request constitutes a covered application.

Timing and Manner of Collection
As a general standard, a covered financial institution must not discourage an applicant from responding to requests for applicant-provided data and must otherwise maintain procedures to collect such data at a time and in a manner that are reasonably designed to obtain a response. A financial institution is given flexibility to establish procedures that work best for its particular lending model and product offerings, provided the procedures are reasonably designed to collect the applicant-provided data.

The final rule provides considerations to include in a financial institution's procedures in order for the collection of applicant-provided data to be consider "reasonably designed":

- The initial request for applicant-provided data occurs prior to notifying an applicant of final action taken on a covered application.
- The request for applicant-provided data is prominently displayed or presented.
- The collection does not have the effect of discouraging an applicant from responding to a request for applicant-provided data.
- Applicants can easily respond to a request for applicant-provided data.

While financial institutions may have flexibility concerning when applicant-provided data is collected, commentary in the final rule provides that under no circumstance may the initial request for applicant-provided data occur simultaneous with or after notifying an applicant of final action taken on a covered application. Generally, the earlier in the application process the financial institution initially seeks to collect applicant-provided data, the more likely the timing of collection is reasonably designed to obtain a response. The final rule does allow for some previously collected data to be reused, and sets forth when previously collected data must be updated.

In collecting data from its small business customers, financial institutions are permitted to rely upon information provided by the applicant, or appropriate third-party sources. Institutions are not required to verify the data. However, if the financial institution does verify applicant statements or information for its own business purposes, such as statements relating to gross annual revenue or time in business, the financial institution must report the verified information.

What Data is to be Collected

Covered financial institutions are to collect data regarding covered applications from small business loan applications. The collected data will later be reported to CFPB and made public in accordance with the reporting and publication components of the final rule.

The following is a list of the data points to be collected, a brief description, and Regulation B references. The final rule sets forth specific filing instructions for codes to be used for particular data fields. The specific filing instructions are not included in the summary chart below but may be pulled from resources provided at the end of the article.

Data Point	Description	Regulation B Reference
Unique Identifier	An alphanumeric application or unique loan identifier	§1002.107(a)(1), comments 107(a)(1)-1 and -2
Application Date	Date application was received	§ 1002.107(a)(2), comments 107(a)(2)-1 through -4
Application Method	Means by which application was submitted	§1002.107(a)(3), comment 107(a)(3)-1

Application Recipient	Whether application was submitted directly or indirectly to bank	§1002.107(a)(4), comment 107(a)(4)-1
Credit Type: Credit Product	Credit product applied for or originated	§1002.107(a)(5)(i), comments 107(a)(5)-1 through -6
Credit Type: Guarantee Type	Type(s) of guarantees for credit product	§1002.107(a)(5)(ii), comment 107(a)(5)-7
Credit Type: Loan Term	Number of months after which legal obligation mature or terminate, measured from date of origination. Special measure date rule for transactions involving real property	§1002.107(a)(5)(iii), comment 107(a)(5)-8
Credit Purpose	Purpose credit was applied for or originated	§1002.107(a)(6), comments 107(a)(6)-1 through -8
Amount Applied For	Initial amount of credit or credit limit requested by applicant	§1002.107(a)(7), comments 107(a)(7)-1 through -5
Amount Approved or Originated	Credit amount or credit limit approved or originated	§1002.107(a)(8), comments 107(a)(8)-1 through -6
Action Taken	Action bank took on application	§1002.107(a)(9), comments 107(a)(9)-1 through -5
Action Taken Date	Date bank took action on application	§1002.107(a)(10), comments 107(a)(10)-1 through -5
Denial Reasons	Principal reason(s) for denial	§1002.107(a)(11), comment 107(a)(11)-1 and -2
Pricing Information: Interest Rate Type	Type of interest rate that applies	§1002.107(a)(12)(i), comments 107(a)(12)-1 through-3
Pricing Information: Initial Rate Period	Term of any initial rate period	§1002.107(a)(12)(i), comment 107(a)(12)-1, and comments 107(a)(12)(i)-2
Pricing Information: Fixed Interest Rate Value	If fixed interest rate, the rate	§1002.107(a)(12)(1)(A), comments 107(a)(12)-1, and comments 107(a)(12)(i)-1 through -3
Pricing Information: Variable Index Rate	If variable or adjustable rate, the index value	§1002.107(a)(12)(i)(B), comment 107(a)(12)-1, and comments 107(a)(12)(i)-1 through -3, and -5

Pricing Information: Variable Interest Rate Margin Value	If variable rate product has margin, the margin	§1002.107(a)(12)(i)(B), comment 107(a)(12)-1 and comments 107(a)(12)(i)-1 through -3
Pricing Information: Variable Interest Rate Index Name	Name of variable rate product's index	§1002.107(a)(12)(i)(B), comment 107(a)(12)-1, and comment 107(a)(12)(i)-4
Pricing Information: Total Origination Charges	Total amount of origination charges	§1002.107(a)(12)(ii), comment 107(a)(12)-1, and comments 107(a)(12)(ii)-1 though -6
Pricing Information: Total Broker Fees	Total amount of broker fees charged at origination	§1002.107(a)(12)(iii), comment 107(a)(12)-1, and comments 107(a)(12)(iii)-1 and -2
Pricing Information: Initial Annual Charges	Total amount of non-interest charges scheduled to be imposed first annual period	§1002.107(a)(12)(iv), comment 107(a)(12)-1, and comments 107(a)(12)(iv)-1 through -6
Pricing Information: MCA/Sales Based Financing Costs	Amount applicant required to pay to receive merchant cash advance or other sales-based financing transaction	§1002.107(a)(12)(v), comment 107(a)(12)-1, and comment 107(a)(12)(v)-1
Pricing Information: Prepayment Penalty Availability	Whether bank may charge prepayment penalty	§1002.107(a)(12)(vi)(A), comment 107(a)(12)-1, comments 107(a)(12)(vi)-1 and -2
Pricing Information: Prepayment Penalty Included	Whether terms of contract include prepayment penalty	§1002.107(a)(12)(vi)(B), comment 107(a)(12)-1, comments 107(a)(12)(vi)-1 and -2
Census Tract: Address Type	Address type used to determine census tract	§1002.107(a)(13), comments 107(a)(13)-1 through -4
Census Tract: Tract Number	Census tract number	§1002.107(a)(13), comments 107(a)(13)-1 through -4
Gross Annual Revenue	Gross annual revenue for applicant in preceding FY	§1002.107(a)(14), comments 107(a)(14)-1 through -4
NAICS Code	Industry type of applicant's business	§1002.107(a)(15), comments 107(a)(15)-1 through -3
Number of Workers	Range of non-owner workers working for applicant	§1002.107(a)(16), comments 107(a)(16)-1 through -3
Time in Business	Number of years applicant's time in business	§1002.107(a)(17), comments 107(a)(17)-1 through -3

Business Ownership Status	Whether applicant is minority-owned, women-owned, or LGBTQI+-owned	§1002.107(a)(18), 1002.102(m), 1002.102(s), 1002,102(f), and comments 107(a)(18)-1 through -9, Appendix E
Number of Principal Owners	Total number of owners that have at least a 25% direct ownership interest	§1002.107(a)(20), 1002.102(o), comments 107(a)(20)-1 through -3
Ethnicity of Principal Owners 1,2,3 and 4	Principal owner(s) ethnicity	§1002.107(a)(19), comments 107(a)(19)-1 through -13, and -16, Appendix E
Race of Principal Owners 1,2,3 and 4	Principal owner(s) race	§1002.107(a)(19), comments 107(a)(19)-1 through -12, -14, and -16, Appendix E
Sex/Gender of Principal Owners 1,2,3 and 4	Principal owner(s) sex/gender	§1002.107(a)(19), comments 107(a)(19)-1 through -12, and -15, Appendix E

Firewall

As a general requirement of the final rule, an employee or officer involved in making any determination concerning an applicant's covered application must not have access to an applicant's responses to inquiries regarding whether the applicant is a minority-owned business, a women-owned business, or an LGBTQI+-owned business, or regarding the ethnicity, race, and sex of the applicant's principal owners. "Have access" means that the employee or officer may need to collect, see, consider, refer to, or otherwise use the information to perform that person's assigned job duties.

"Involved in making any determination concerning a covered application from a small business" means participating in a decision regarding the evaluation of a covered application from a small business or the creditworthiness of a small business applicant for a covered credit transaction.

The "firewall" will not apply if the financial institution determines that it is not feasible to limit an employee's or officer's access to an applicant's responses. It is not feasible to limit access if the financial institution determines that an employee or officer involved in making any determination concerning a covered application from a small business should have access to one or more applicants' responses.

<u>Notice</u>
In order to satisfy the firewall exception, a financial institution must provide a notice to each applicant whose responses will be accessed. The notice is found in Appendix E to the final rule.

Reporting

On or before June 1 following the calendar year for which data are compiled and maintained, a covered financial institution must submit its small business lending application register in the format prescribed by CFPB. An authorized representative of the covered financial institution with knowledge of the data need certify to the accuracy and completeness of the data reported.

A covered financial institution is also to report:

- Its name
- Its headquarters address
- Name and business contact information of a person that CFPB or other regulators may contact about the financial institution's submission
- Its Federal prudential regulator, if applicable
- Its Federal Taxpayer Identification Number (TIN)
- Its Legal Entity Identifier (LEI)
- Its Research, Statistics, Supervision, and Discount identification (RSSD ID) number, if applicable
- Parent entity information, if applicable, including:
    - The name of the immediate parent entity;
    - The LEI of the immediate parent entity, if available;
    - The RSSD ID number of the immediate parent entity, if available;
    - The name of the top-holding parent entity;
    - The LEI of the top-holding parent entity, if available; and
    - The RSSD ID number of the top-holding parent entity, if available.
- The type of financial institution that it is, indicated by selecting the appropriate type or types of institution from the list provided
- Whether the financial institution is voluntarily reporting covered applications from small businesses

Covered financial institutions are to follow CFPB's Filing Instructions Guide for the submission of data.

Publication of Reported Data

CFPB is required to make public data reported to it by financial institutions, subject to deletions or modifications made by CFPB if CFPB determines that the deletion or modification of data would advance a privacy interest. Data will be published on an annual basis. CFPB also has the authority to compile and aggregate data and may publish such data as it deems appropriate.

The final rule requires a covered financial institution to make available to the public on its website, or otherwise upon request, a statement that its small business lending application register is or will be available from CFPB.

The final rule also prohibits a covered financial institution from disclosing or providing to a third party information it collected regarding whether a small business is minority-owned, women-owned, or LGBTQI+-owned or information regarding the ethnicity, race, and sex of principal owners except as permitted by law.

Recordkeeping

A covered financial institution must retain evidence of compliance with Section 1071, which includes a copy of its small business lending application register, for at least three years after the register is required to be submitted to CFPB.

The financial institution is also required to maintain, separately from the rest of the application and accompanying information, an applicant's response to the institution's inquiries regarding whether the applicant is a small business, is minority-owned, women-owned, or LGBTQI+-owned, or information regarding the ethnicity, race, and sex of the applicant's principal owners.

In reporting a small business lending application register, maintaining the register, and maintaining a separate record of information, a financial institution must not include any name, specific address, telephone number, email address, or any other personally identifiable information concerning any individual who is, or is connected with, an applicant.

Enforcement

Violations of Section 1071 rules subjects a covered financial institution to administrative sanctions and civil liability.

Bona Fide Errors
The final rule provides that a bona fide error in compiling, maintaining, or reporting data with respect to a covered application is one that was unintentional and occurred despite the maintenance of procedures reasonably adapted to avoid such an error. A bona fide error is not a violation of Section 1071.

A financial institution is presumed to maintain procedures reasonably adapted to avoid such errors with respect to a given data field if the number of errors found in a random sample of the financial institution's submission for the data field does not equal or exceed a threshold specified by CFPB for this purpose in Appendix F to the rule. However, an error is not a bona fide error if either there is a reasonable basis to believe the error was intentional or there is evidence that the financial institution does not or has not maintained procedures reasonably adapted to avoid such errors.

Safe Harbors
The final rule provides for a few safe harbors which are not violations of Section 1071:

- Incorrect entry for application date. It is not a violation if the date reported is within three business days of the actual application date.
- Incorrect entry for census tract. It is not a violation if the census tract reported was obtained correctly using a geocoding tool provided by FFIEC or CFPB.
- Incorrect entry for NAICS code. It is not a violation if the financial institution obtained the 3-digit NAICS code by either (a) relying on an applicant's representations or on an appropriate third-party source, regarding the NAICS code; or (b) identifying the NAICS code itself, provided that the financial institution maintains procedures reasonably adapted to correctly identify a 3-digit NAICS code.
- Incorrect determination of small business status, covered credit transaction, or covered application. It is not a violation if the financial institution that initially collects data regarding whether an applicant for a covered credit transaction is a minority-owned business, a women-owned business, or an LGBTQI+-owned business, and the ethnicity, race, and sex of the applicant's principal owners but later concludes that it should not have collected such data, if the financial institution, at the time it collected this data, had a reasonable basis for believing that the application was a covered application for a covered transaction from a small business.

Compliance Dates

The final rule provides for staggered implementation dates:

- A covered financial institution that originated **at least 2,500** covered credit transactions for small businesses in each of calendar years 2022 and 2023 shall comply beginning **October 1, 2024**.
- A covered financial institution that originated **less than 2,500** but **at least 500** covered credit transactions for small businesses in each of calendar years 2022 and 2023 shall comply beginning **April 1, 2025**.
- A covered financial institution that originated **less than 500** but **at least 100** covered credit transactions for small businesses in each of calendar years 2022 and 2023 shall comply beginning **January 1, 2026**.

Covered financial institution is permitted, but not required, to collect information regarding whether an applicant for a covered credit transaction is a minority-owned business, a women-owned business, and/or an LGBTQI+-owned business, and the ethnicity, race, and sex of the applicant's principal owners beginning 12 months prior to its applicable compliance date.

A financial institution that is unable to determine the number of covered credit transactions it originated for small businesses in each of calendar years 2022 and 2023 for purposes of determining its compliance, because for some or all of this period it does not have readily accessible the information needed to determine whether its covered credit transactions were originated for small businesses is permitted to use any reasonable method to estimate its originations to small businesses for either or both of the calendar years 2022 and 2023.

A financial institution that did not originate at least 100 covered credit transactions for small businesses in each of calendar years 2022 and 2023 but subsequently originates at least 100 such transactions in two consecutive calendar years shall comply with the requirements no earlier than January 1, 2026.

Summary and Resources

CFPB has released its final Section 1071 rule which revises Regulation B to require covered financial institutions to collect and report certain data on applications for credit by small businesses, retain records for compliance with the rule, and to create a firewall to keep some collected data away from certain employees and officers unless notice is given to applicants.

As compliance officers shift to more fully understand the requirements of the new rule and to creating implementation and training plans, the following resources have been created by CFPB regarding its rule.

Final Section 1071 Rule: https://files.consumerfinance.gov/f/documents/cfpb_1071-final-rule.pdf

CFPB has created a Section 1071 Implementation Webpage which hosts several helpful materials, including an executive summary of the rule, a data point chart, sample data collection forms, and CFPB's Filing Instruction Guide.

The webpage may be viewed at: https://www.consumerfinance.gov/compliance/compliance-resources/small-business-lending-resources/small-business-lending-collection-and-reporting-requirements/

CFPB also created a question portal for Section 1071-related questions. The portal may be found at: https://sblhelp.consumerfinance.gov/

Also, the June 2023 WBA Compliance Forum session will provide compliance personnel with a detailed breakdown and implementation ideas for the new rule. Registration for the WBA Compliance Forum may be found at: https://www.wisbank.com/events/wba-2023-24-compliance-forum-membership-session-1/

Wisconsin Bankers ASSOCIATION

Compliance Journal
March 2023

Special Focus

FDIC Simplification of Deposit Insurance Rules for "Trust Account" Category and Mortgage Servicing Accounts

Financial institutions have just short of a year to prepare for Federal Deposit Insurance Corporation's (FDIC's) rule which amends deposit insurance rules, Part 330. FDIC's amendments were meant to simplify the deposit insurance regulations by establishing a ''trust accounts'' category that governs coverage of deposits of both revocable trusts and irrevocable trusts using a common calculation, and provide consistent deposit insurance treatment for all mortgage servicing account balances held to satisfy principal and interest obligations to a lender.

This article outlines the rule changes for trust deposits and mortgage servicing accounts, provides recommendations to consider in advance of the effective date, and provides links to various resources. The final rule is effective **April 1, 2024**.

I. Background

Before discussing the recent rule amendments, a quick mention of the current categories of deposit insurance is helpful as sections of the revised rule refer to the other categories. A mention of the standard deposit insurance coverage amount is also helpful in understanding the impact of the changes.

FDIC's current deposit insurance ownership categories consist of: (a) single accounts; (b) certain retirement accounts; (c) joint accounts; (d) revocable trust accounts; (e) irrevocable trust accounts; (f) employee benefit plan accounts; (g) corporation/partnership/unincorporated association accounts; and (h) government accounts.

FDIC's standard maximum deposit insurance amount (SMDIA) is $250,000 per depositor, per insured bank, for each account ownership category. This means a customer who has multiple accounts may qualify for more than $250,000 of deposit insurance coverage if the customer's funds are deposited in different ownership categories and the requirements of each ownership category are met. Each category of coverage has requirements that need be met for deposits to be covered under the particular category. As this article is focused on the changes made to trust deposits and mortgage servicing accounts, it does not address the requirements of other categories. However, the information may be found in the resources provided at the end of the article.

II. Current Rules for Coverage of Trust Deposits

Revocable Trusts

FDIC currently recognizes three different insurance categories for deposits held in connection with trusts: (1) revocable trusts; (2) irrevocable trusts; and (3) irrevocable trusts with an insured depository institution (IDI) as trustee.

The revocable trust category applies to deposits for which the depositor has evidenced an intention that the deposit will belong to one or more beneficiaries upon his or her death. The category includes deposits held in connection with formal revocable trusts—that is, revocable trusts established through a written trust agreement. It also includes deposits that are not subject to a formal trust agreement, where the IDI makes payment to the beneficiaries identified in the IDI's records upon the depositor's death based on account titling and applicable State law (*i.e.*, payable on death (POD) account). FDIC refers to accounts with a POD designation as "informal revocable trusts."

Deposits associated with formal and informal revocable trusts are aggregated for purposes of the deposit insurance rules; thus, deposits that will pass from the same grantor to beneficiaries are aggregated and insured up to the SMDIA, currently $250,000, per beneficiary, regardless of whether the transfer would be accomplished through a written revocable trust or an informal revocable trust.

Under the current revocable trust deposit coverage rules, beneficiaries include natural persons, charitable organizations, and non-profit entities recognized as such under the Internal Revenue Code. Such beneficiaries are referred to as "eligible beneficiaries." For FDIC deposit insurance purposes, if a named beneficiary does not qualify as a beneficiary, funds held in trust for that beneficiary are treated as single ownership funds of the grantor and aggregated with any other single ownership account that the grantor maintains at the same IDI.

Certain requirements also must be satisfied for a deposit to be insured under the revocable trust category. In particular, the grantor must intend that the funds will belong to the beneficiaries upon the depositor's death, and this intention must be manifested in the ''title'' of the account using commonly accepted terms such as ''payable-on-death to,'' or any acronym for the terms (*i.e.*, POD). For purposes of this requirement, ''title'' includes the IDI's electronic deposit account records. For example, an IDI's electronic deposit account records could identify the account as a revocable trust account through coding or a similar mechanism.

Additionally, the beneficiaries of informal revocable trusts must be named in the IDI's deposit account records. Since 2004, the requirement to name beneficiaries in the IDI's deposit account records has not applied to formal revocable trusts; FDIC generally obtains information on beneficiaries of such trusts from depositors following an IDI's failure.

The calculation of deposit insurance coverage for revocable trust deposits category depends upon the number of unique beneficiaries named by a depositor. If five or fewer beneficiaries have been named, the depositor is insured in an amount up to the total number of named beneficiaries multiplied by the SMDIA, and the specific allocation of interests among the beneficiaries is not considered.

If more than five beneficiaries have been named, the depositor is insured up to the greater of: (1) five times the SMDIA; or (2) the total of the interests of each beneficiary, with each such interest limited to the SMDIA. For purposes of this calculation, a life estate interest is valued at the SMDIA.

Where a revocable trust deposit is jointly owned by multiple co-owners, the interests of each account owner are separately insured up to the SMDIA per beneficiary. However, if the co-owners are the only beneficiaries of the trust, the account is instead insured under FDIC's joint account category. Lastly, if a revocable trust becomes irrevocable due to the death of the grantor, the trust's deposit may continue to be insured under the revocable trust rules.

Irrevocable Trust Deposits

Deposits held by an irrevocable trust that has been established either by written agreement or by statute are insured in the irrevocable trust deposit insurance category.

March 2023
Volume 28, Number 10

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Calculating coverage for deposits insured in this category requires a determination of whether beneficiaries' interests in the trust are contingent or non-contingent. This determination is best made between the customer and FDIC directly. Noncontingent interests are interests that may be determined without evaluation of any contingencies, except for those covered by the present worth and life expectancy tables and the rules for their use set forth in IRS federal estate tax regulations. Funds held for noncontingent trust interests are insured up to the SMDIA for each such beneficiary. Funds held for contingent trust interests are aggregated and insured up to the SMDIA in total.

The irrevocable trust rules do not apply to deposits held for a grantor's retained interest in an irrevocable trust. Such deposits are aggregated with the grantor's other single ownership deposits for purposes of applying the deposit insurance limit.

Deposits Held by an IDI as Trustee of an Irrevocable Trust

For deposits held by an IDI in its capacity as trustee of an irrevocable trust, deposit insurance coverage is governed by section 7(i) of the Federal Deposit Insurance Act (FDI Act). Section 7(i) provides that "[t]rust funds held on deposit by an insured depository institution in a fiduciary capacity as trustee pursuant to any irrevocable trust established pursuant to any statute or written trust agreement shall be insured in an amount not to exceed the standard maximum deposit insurance amount... for each trust estate."

FDIC's regulations governing coverage for deposits held by an IDI in its capacity as trustee of an irrevocable trust are found in Part 330.12. The rule provides that "trust funds" held by an IDI in its capacity as trustee of an irrevocable trust, whether held in the IDI's trust department or another department, or deposited by the fiduciary institution in another IDI, are insured up to the SMDIA for each owner or beneficiary represented. This coverage is separate from the coverage provided for other deposits of the owners or the beneficiaries, and deposits held for a grantor's retained interest are not aggregated with the grantor's single ownership deposits.

III. Amendments to Trust Deposits Made by the Final Rule

FDIC's final rule makes the following changes and clarifications to deposit insurance coverage for trust accounts:

Merger of Revocable and Irrevocable Trust Categories

The final rule amends Part 330.10 of FDIC's regulations, which currently applies only to revocable trust deposits, to establish a new "trust accounts" category. This new category will now include both revocable and irrevocable trust deposits.

The types of deposits that will be included in the new category include:

(1) Informal revocable trust deposits, such as payable-on-death (POD) accounts;

(2) Formal revocable trust deposits, defined to mean deposits held pursuant to a written revocable trust agreement under which a deposit passes to one or more beneficiaries upon the grantor's death; and

(3) Irrevocable trust deposits, meaning deposits held pursuant to an irrevocable trust established by written agreement or by statute.

Because these deposits will now be part of the same category for deposit insurance purposes, they would be aggregated when applying the deposit insurance limit.

As amended, Part 330.10 does not apply to deposits maintained by an IDI in its capacity as trustee of an irrevocable trust; these deposits are insured separately pursuant to section 7(i) of the FDI Act and Part 330.12 of FDIC's deposit insurance regulations.

Calculation of Coverage

FDIC will use one streamlined calculation to determine the amount of deposit insurance coverage for deposits of revocable and irrevocable trusts under the new “trust account” category. This method is already utilized by FDIC to calculate coverage for revocable trusts that have five or fewer beneficiaries. FDIC claims the current method is generally well-understood by bankers and trust depositors.

The new rule provides that a grantor’s trust deposits will be insured in an amount up to the SMDIA (currently $250,000) multiplied by the number of trust beneficiaries, not to exceed five beneficiaries. This, in effect, will limit coverage for a grantor’s trust deposits at each IDI to a total of $1,250,000; in other words, maximum coverage of $250,000 per beneficiary for up to five beneficiaries.

FDIC stated in its final rule that the $1,250,000 per-grantor, per-IDI limit is intended to be more straightforward and balance the objectives of simplifying the trust rules, promotes timely payment of deposit insurance, facilitates resolutions, ensures consistency with the FDI Act, and limits risk to the Deposit Insurance Fund (DIF).

Eligible Beneficiaries

As mentioned above, the current revocable trust deposit insurance rules provide that beneficiaries include natural persons, charitable organizations, and non-profit entities recognized as such under the Internal Revenue Code. The irrevocable trust rules do not establish criteria for beneficiaries. The final rule uses the current revocable trust rule’s definition.

The final rule also excludes from the calculation of deposit insurance coverage beneficiaries that only would obtain an interest in a trust if one or more beneficiaries are deceased, *i.e.*, contingent beneficiary interests. The final rule codifies existing practice to include only primary, unique beneficiaries in the deposit insurance calculation. Consistent with current treatment, naming a chain of contingent beneficiaries that would obtain trust interests only in event of a beneficiary’s death will not increase deposit insurance coverage.

Finally, FDIC has also codified a longstanding interpretation of the rules under which an informal revocable trust designates the depositor’s formal trust as its beneficiary. A formal trust generally does not meet the definition of an eligible beneficiary for deposit insurance purposes. However, FDIC will treat such accounts as revocable trust accounts under the deposit insurance rules, insuring the account as if it were titled in the name of the formal trust.

Retained Interests and Ineligible Beneficiaries’ Interests

The current deposit insurance rules for trust accounts provide that in some instances, funds intended for specific beneficiaries are aggregated with a grantor’s single ownership deposits at the same IDI for purposes of the deposit insurance calculation. These instances include a grantor’s retained interest in an irrevocable trust and interests of ineligible beneficiaries that do not satisfy the definition of a revocable trust ‘‘beneficiary.’’ This adds complexity to the deposit insurance calculation, as a detailed review of a trust agreement may be required to value such interests in order to aggregate them with a grantor’s single ownership funds. In order to implement the streamlined calculation for trust deposits, FDIC is eliminating the provisions.

Under the final rule, the grantor and other beneficiaries that do not satisfy the definition of ‘‘eligible beneficiary’’ are not included in the deposit insurance calculation. Importantly, the change does not in any way limit a grantor’s ability to establish such trust interests under State law; the interests simply do not factor into the calculation of deposit insurance coverage.

Future Trusts Named as Beneficiaries

Trusts often contain provisions for the establishment of one or more new trusts upon the grantor’s death, and the final rule clarifies deposit insurance coverage in these situations. Specifically, if a trust agreement provides that trust funds will pass into one or more new trusts upon the death of the grantor(s), the future trust(s) will not be treated as beneficiaries for purposes of the calculation of deposit insurance coverage. Rather, the future trust(s) will be considered mechanisms for distributing trust funds, and the natural persons or organizations that receive the trust funds through the future trusts will be considered the beneficiaries for purposes of the deposit insurance calculation. This clarification is consistent with published guidance and does not represent a substantive change in deposit insurance coverage.

Naming of Beneficiaries in Deposit Account Records

The final rule continues to require the beneficiaries of an informal revocable trust to be specifically named in the deposit account records of the IDI.

Presumption of Ownership

Consistent with the current deposit insurance rules for revocable trusts, the final rule provides that, unless otherwise specified in an IDI's deposit account records, a deposit of a trust established by multiple grantors will be presumed to be owned in equal shares.

Bankruptcy Trustee Deposits

FDIC will maintain the current treatment of deposits placed at an IDI by a bankruptcy trustee. Under the final rule, if funds of multiple bankruptcy estates are commingled in a single account at the IDI, each estate will be separately insured up to the SMDIA.

Deposits Covered Under Other Rules

The final rule excludes from coverage under Part 330.10 certain trust deposits that are covered by other sections of the deposit insurance regulations. For example, employee benefit plan deposits are insured pursuant to Part 330.14, and investment company deposits are insured as corporate deposits pursuant to Part 330.11. Deposits held by an IDI in its capacity as trustee of an irrevocable trust are insured pursuant to Part 330.12. In addition, if the co-owners of an informal or formal revocable trust are the trust's sole beneficiaries, deposits held in connection with the trust are treated as joint deposits under Part 330.9. In each of these cases, FDIC did not alter the current rules.

IV. Mortgage Servicing Accounts

Current Rule

FDIC's rules governing coverage for mortgage servicing accounts were originally adopted in 1990 following the transfer of responsibility for insuring deposits of savings associations from the Federal Savings and Loan Insurance Corporation (FSLIC) to FDIC. Under the rules adopted in 1990, deposits comprised of payments of principal and interest were insured on a pass-through basis to lenders, mortgagees, investors, or security holders (Lenders). In adopting the rule, FDIC focused on the fact that principal and interest funds were generally owned by Lenders, on whose behalf the servicer, as agent, accepted principal and interest payments. By contrast, payments of taxes and insurance were insured to the mortgagors or borrowers on a passthrough basis because the borrower owns such funds until tax and insurance bills are paid by the servicer.

In 2008, FDIC therefore amended its rules to provide coverage to Lenders based on each mortgagor's payments of principal and interest into the mortgage servicing account, up to the SMDIA (currently $250,000) per mortgagor. FDIC did not amend the rule for coverage of tax and insurance payments, which continued to be insured to each mortgagor on a pass-through basis and aggregated with any other deposits maintained by each mortgagor at the same IDI in the same right and capacity. The 2008 amendments to the rules for mortgage servicing accounts did not provide for the fact that servicers may be required to advance their own funds to make payments of principal and interest on behalf of delinquent borrowers to the Lenders. However, this is required of mortgage servicers under some mortgage servicing arrangements.

The current rule provides coverage for principal and interest funds only to the extent "paid into the account by the mortgagors." The current rule does not provide coverage for funds paid into the account from other sources, such as the servicer's own operating funds, even if those funds satisfy mortgagors' principal and interest payments. As a result, deposits into a mortgage servicing account by a servicer for the purpose of making an advance are not provided the same level of coverage as other deposits in a mortgage servicing account consisting of principal and interest payments directly from the borrower, which are insured up to the SMDIA for each borrower. Instead, the advances are aggregated and insured to the servicer as corporate funds for a total of $250,000.

Mortgage Servicing Final Rule

Under the final rule, accounts maintained by a mortgage servicer in an agency, custodial, or fiduciary capacity, for the purpose of payment of a borrower's principal and interest obligations, will be insured for the cumulative balance paid into the account in order to satisfy principal and interest obligations to the Lender, whether paid directly by the borrower or by another party, up to the limit of the SMDIA per mortgagor. Mortgage servicers' advances of principal and interest funds on behalf of delinquent borrowers would therefore be insured up to the SMDIA per mortgagor, consistent with the coverage rules for payments of principal and interest collected directly from borrowers.

Under the final rule, the composition of a mortgage servicing account attributable to principal and interest payments would also include collections by a servicer, such as foreclosure proceeds, that are used to satisfy a borrower's principal and interest obligations to the Lender. These funds will be insured up to the limit of the SMDIA per mortgagor.

FDIC did not propose changes to the deposit insurance coverage provided for mortgage servicing accounts comprised of payments from mortgagors of taxes and insurance premiums. Such aggregate escrow accounts are held separately from the principal and interest mortgage servicing accounts and the deposits therein are held in trust for the mortgagors until such time as tax and insurance payments are disbursed by the servicer on the borrower's behalf. Such deposits continued to be insured based on the ownership interest of each mortgagor in the account and aggregated with other deposits maintained by the mortgagor at the same IDI in the same capacity and right.

V. Actionable Steps

During this time before the final rule's effective date, IDIs should take steps to help identify what deposit customers may be impacted by the combination of revocable trust and irrevocable trust categories into the one "trust accounts" category and consider potential outreach to affected customers regarding the changes to deposit insurance rules. IDIs will also have an opportunity to review the changes in coverage, train employees, and update publications if necessary.

Financial institutions who have identified customers affected by the final rule and who seek to offer additional insurance protection beyond that which is covered under FDIC's Part 330 may want to consider reaching out to their various resources for product and pricing options for additional insurance.

In addition, covered institutions under FDIC's Recordkeeping for Timely Deposit Insurance Determination Rule, codified at Part 370, will need to implement changes to recordkeeping and information technology capabilities. "Covered institutions," in general, are IDIs which have 2 million or more deposit accounts during the two consecutive quarters preceding the compliance dates outlined in Part 370.

VI. Conclusion and Resources

The final rule is effective **April 1, 2024**. The amendments merge the revocable and irrevocable trust deposit insurance categories into one category, ''trust accounts.'' Coverage for deposits in the category will be calculated through a simple calculation. Each grantor's trust deposits will be insured in an amount up to the SMDIA multiplied by the number of trust beneficiaries, not to exceed five. This, in effect, will limit coverage for a grantor's trust deposits at each IDI to a total of $1,250,000; in other words, maximum coverage of $250,000 per beneficiary for up to five beneficiaries.

Accounts maintained by a mortgage servicer in an agency, custodial, or fiduciary capacity, for the purpose of payment of a borrower's principal and interest obligations, will be insured for the cumulative balance paid into the account in order to satisfy principal and interest obligations to the Lender, whether paid directly by the borrower or by another party, up to the limit of the SMDIA per mortgagor. Mortgage servicers' advances of principal and interest funds on behalf of delinquent borrowers will be insured up to the SMDIA per mortgagor, consistent with the coverage rules for payments of principal and interest collected directly from borrowers. Also, included in the funds insured up to the limit of SMDIA per mortgagor, collections by a servicer, such as foreclosure proceeds, that are used to satisfy a borrower's principal and interest obligations to the Lender.

FDIC's Final Rule, Simplification of Deposit Insurance Rules:
https://www.govinfo.gov/content/pkg/FR-2022-01-28/pdf/2022-01607.pdf

Current FDIC Part 330 Deposit Insurance Coverage Rules:
https://www.ecfr.gov/current/title-12/chapter-III/subchapter-B/part-330

FDIC Deposit Insurance Resources, generally:
https://www.fdic.gov/resources/deposit-insurance/

Midwest Bankers Insurance Services, Excess Deposit Bond:
https://www.mbisllc.com/MBIS/Home/MBIS/Default.aspx?hkey=1c3dc91a-1f60-4612-816f-632811b9a208

FinCEN Issues Alert on Nationwide Surge in Mail Theft-Related Check Fraud Schemes

Late February, the Financial Crimes Enforcement Network (FinCEN) issued an alert to financial institutions given the nationwide surge in check fraud schemes which target the U.S. Mail (mail theft-related check fraud). FinCEN issued the alert in close collaboration with the United States Postal Inspection Service (USPIS) to ensure that suspicious activity reports (SARs) filed by financial institutions appropriately identify and report suspected check fraud schemes that may be linked to mail theft in the United States.

Mail theft-related check fraud generally pertains to the fraudulent negotiation of checks stolen from the U.S. Mail. The term "U.S. Mail" includes all mail distributed and delivered through and by the Postal Service. This includes First-Class Mail such as mailed letters, cards, or other correspondence, which may contain checks, money orders, personal identifiable information, and credit cards/debit cards.

Fraud, including check fraud, is the largest source of illicit proceeds in the United States and represents one of the most significant money laundering threats to the United States, as highlighted in the Treasury's most recent National Money Laundering Risk Assessment and National Strategy for Combatting Terrorist and other Illicit Financing publications. Fraud is also one of the anti-money laundering/countering the financing of terrorism (AML/CFT) National Priorities.

Emerging Trends

Despite the declining use of checks in the United States, criminals have been increasingly targeting the U.S. Mail since the COVID-19 pandemic to commit check fraud. From March 2020 through February 2021, USPIS received 299,020 mail theft complaints, which was an increase of 161 percent compared with the same period a year earlier. Bank Secrecy Act (BSA) reporting for check fraud has also increased in the past three years. In 2021, financial institutions filed more than 350,000 SARs to FinCEN to report potential check fraud, a 23 percent increase over the number of check fraud-related SARs filed in 2020. This upward trend continued into 2022, when the number of SARs related to check fraud reached over 680,000, nearly double the previous year's amount of filings.

Mail Theft Risks and Vulnerabilities

Criminals committing mail theft-related check fraud generally target the U.S. Mail in order to steal personal checks, business checks, tax refund checks, and checks related to government assistance programs, such as Social Security payments and unemployment benefits. Criminals will generally steal all types of checks in the U.S. Mail as part of a mail theft scheme, but business checks may be more valuable because business accounts are often well-funded, and it may take longer for the victim to notice the fraud. FinCEN and USPIS report there have been cases of Postal Service employees stealing checks at United States Postal Service (USPS) sorting and distribution facilities. However, according to USPIS, mail theft-related check fraud is increasingly committed by non-USPS employees, ranging from individual fraudsters to organized criminal groups comprised of the organizers of the criminal scheme, recruiters, check washers, and money mules.

These criminals, located throughout the country, target USPS blue collection boxes, unsecured residential mailboxes, and privately owned cluster box units at apartment complexes, planned neighborhoods, and high-density commercial buildings. Mail theft can occur through forced entry or the use of makeshift fishing devices, and increasingly involves the use of authentic or counterfeit USPS master keys, known as Arrow Keys. Arrow Keys open USPS blue collection boxes and cluster box units within a geographic area, and a number of recent cases involve organized criminals violently targeting USPS mail carriers with the intent of stealing Arrow Keys. FinCEN and USPIS report there have also been cases of corrupt Postal Service employees who unlawfully provide Arrow Keys to criminal actors to facilitate mail theft. Illicit actors may also copy and sell stolen Arrow Keys to third-party fraudsters on the dark web and through encrypted social media platforms in exchange for convertible virtual currency.

After stealing checks from the U.S. Mail, fraudsters and organized criminal groups may alter or "wash" the checks, replacing the payee information with their own or fraudulent identities or with business accounts that the criminals control. During check washing, these illicit actors also often increase the dollar amount on the check, sometimes by hundreds or thousands of dollars. Washed checks may also be copied, printed, and sold to third-party fraudsters on the dark web and encrypted social media platforms in exchange for convertible virtual currency. In some cases, victim checks are also counterfeited using routing and account information from the original, stolen check. Illicit actors may cash or deposit checks in person at financial institutions, through automated teller machines (ATMs), or via remote deposit into accounts they control, and which they often open specifically for the check fraud schemes. Criminals may also rely on money mules and their pre-existing accounts to deposit fraudulent checks. Regardless, once the checks are deposited, the illicit actors often rapidly withdraw the funds through ATMs or wire them to other accounts that they control to further obfuscate their ill-gotten gains. The criminals may further exploit the victims by using personal identifiable information found in the stolen mail for future fraud schemes such as credit card fraud or credit account fraud.

Red Flags to Help Detect and Prevent Suspicious Activity

FinCEN and USPIS have identified red flags to help financial institutions detect, prevent, and report suspicious activity connected to mail theft-related check fraud, many of which overlap with red flags for check fraud in general. As no single red flag is determinative of illicit or suspicious activity, financial institutions should consider the surrounding facts and circumstances, such as a customer's historical financial activity, whether the transactions are in line with prevailing business practices, and whether the customer exhibits multiple red flags, before determining if a behavior or transaction is suspicious or otherwise indicative of mail theft-related check fraud. In line with their risk-based approach to compliance with the BSA, FinCEN encourages financial institutions to perform additional due diligence where appropriate.

1. Non-characteristic large withdrawals on a customer's account via check to a new payee.
2. Customer complains of a check or checks stolen from the mail and then deposited into an unknown account.
3. Customer complains that a check they mailed was never received by the intended recipient.
4. Checks used to withdraw funds from a customer's account appear to be of a noticeably different check stock than check stock used by the issuing bank and check stock used for known, legitimate transactions.
5. Existing customer with no history of check deposits has new sudden check deposits and withdrawal or transfer of funds.
6. Non-characteristic, sudden, abnormal deposit of checks, often electronically, followed by rapid withdrawal or transfer of funds.
7. Examination of suspect checks reveals faded handwriting underneath darker handwriting, giving the appearance that the original handwriting has been overwritten.
8. Suspect accounts may have indicators of other suspicious activity, such as pandemic-related fraud.
9. New customer opens an account that is seemingly used only for the deposit of checks followed by frequent withdrawals and transfer of funds.
10. A non-customer who is attempting to cash a large check or multiple large checks in-person and, when questioned by the financial institution, provides an explanation that is suspicious or potentially indicative of money mule activity.

SAR Filing Request

FinCEN requests that financial institutions indicate a connection between the suspicious activity being reported in a SAR filing and the activity highlighted in the Alert by including key terms in the SAR filing. In particular, the term **"FIN-2023-MAILTHEFT"** should be used in SAR field 2 (Filing Institution Note to FinCEN) and in the narrative. Financial institutions should also select **SAR Field 34(d) (check fraud)**. Financial institutions should also highlight additional advisory or alert key words in the narrative, as applicable.

Financial institutions should include any and all available information relating to the account and locations involved in the reported activity, identifying information and descriptions of any legal entities or arrangements involved and associated beneficial owners, and any information about related persons or entities involved in the activity. Financial institutions also should provide any and all available information regarding other domestic and foreign financial institutions involved in the activity; where appropriate, financial institutions should consider filing a SAR jointly on shared suspicious activity.

Conclusion

Financial institutions should update their SAR filing procedures to incorporate the recommended term and check fraud field selection should a SAR need be filed due to activity highlighted in the Alert. Financial institutions should also review the list of identified red flags to ensure such activity is monitored if it is not already. The Alert (FIN-2023-Alert 0003) may be viewed at: www.fincen.gov/sites/default/files/shared/FinCEN%20Alert%20Mail%20Theft-Related%20Check%20Fraud%20FINAL%20508.pdf

WBA has also created a consumer-facing resource to help financial institutions educate customers regarding how to avoid mail-related check fraud. This and other consumer-facing resources may be viewed under the "Consumer Content" section of the WBA website at: https://www.wisbank.com/resources/consumer-resources/ and https://www.wisbank.com/wp-content/uploads/2023/03/Consumer-Content-Check-Fraud1.pdf

Referenced materials above:
Treasury's "National Money Laundering Risk Assessment" (Feb 2022), pp. 6-7 https://home.treasury.gov/system/files/136/2022-National-Money-Laundering-Risk-Assessment.pdf

Treasury's "National Strategy for Combatting Terrorist and Other Illicit Financing" (May 2022), p. 27 https://home.treasury.gov/system/files/136/2022-National-Strategy-for-Combating-Terrorist-and-Other-Illicit-Financing.pdf

Wisconsin Bankers ASSOCIATION

Compliance Journal
February 2023

Special Focus

In Anticipation of a Final Section 1071 Rule, Banks Should Determine What a "Covered Application" Is?

What does the bank consider to be an application for business-purpose credit? Is it a verbal request? Or does a request need be documented on a particular type of application? Can a request be made via email or via some other electronic method?

With the finalization of the Bureau of Consumer Financial Protection's (CFPB's) small business loan data collection rule (a/k/a Section 1071) forthcoming in the near future, what a bank considers an application for business-purpose or commercial credit will be an important distinction as the request will become a trigger for the need to ask and collect additional information regarding the applicant. As the industry awaits the release of a final Section 1071 rule, each bank should determine what it considers an application for business-purpose credit to help conceptualize how to collect additional data when working with women- or minority-owned businesses and small businesses.

To help with those initial steps, this article outlines what is considered a "covered application" for a "covered credit transaction" under the Section 1071 proposed rule. While it is unknown how CFPB will finalize the rule, by identifying what applications may be covered, banks can begin to identify how the flow of data collection may be accomplished. This preparatory step should assist with implementation of a final rule. Based upon its published semi-annual regulatory agenda, it is expected that CFPB will release a final Section 1071 rule by end of March.

Background

Section 1071 of the Dodd Frank Act amended the Equal Credit Opportunity Act (ECOA) to require that financial institutions collect and report to CFPB data regarding applications for business credit by women- or minority-owned businesses and small businesses. In addition, Section 1071 requires that financial institutions restrict access to underwriters and other persons to certain 1071 data as CFPB fears underwriters will be influenced by such data—resulting in higher or more costly loan terms for the applicant. Section 1071 also imposes recordkeeping requirements and the publication of data after modification or deletion of certain data to protect applicants' privacy interests.

Who is a Covered Financial Institution

As proposed, a "covered financial institution" means a financial institution that originated at least 25 covered credit transactions for small businesses in each of the two preceding calendar years. For example, in 2026, the two preceding calendar years are 2024 and 2025. Accordingly, in 2026, Bank A does not meet the loan-volume threshold if did not originate at least 25 covered credit transactions for small businesses both during 2024 and during 2025.

The calculation is based on total covered credit transactions originated for small businesses, rather than covered applications received. For example, if in both 2024 and 2025, Bank B received 30 covered applications from small businesses and originated 20 covered credit transactions for small businesses, then for 2026, Bank B is not a covered financial institution. As further explained below, a covered credit transaction is generally a request for business credit.

For purposes of this definition, if more than one financial institution was involved in the origination of a covered credit transaction, only the financial institution that made the credit decision approving the application shall count the origination for purposes of this determination. Separate rules apply for merger or acquisition transactions.

What is a Covered Application

Once a bank determines that it has originated at least 25 covered credit transactions for small businesses in each of the two preceding calendar years thereby making Section 1071 rules apply, the bank then need identify what credit applications are subject to the rule.

As a general rule, unless otherwise exempt, banks will need collect and report data about women- or minority-owned businesses and small businesses who have applied for an extension of business credit. This includes a request for any business loan, line of credit, credit cards, and merchant cash advances (collectively, a covered credit transaction). Applications for leases, factoring, credit secured by certain investment properties, trade credit, public utilities credit, securities credit, incidental credit, and consumer-designated credit are exempt, as those terms are further defined under Section 1071.

A covered application means an oral or written request for a covered credit transaction that is made in accordance with procedures used by the bank for the type of credit requested. Section 1071 provides banks with latitude to establish their own application process or procedures, including designating the type and amount of information required from applicants.

The term "procedures" refers to the actual practices followed by a bank, as well as its stated application procedures. For example, if a bank's stated policy is to require all applications to be in writing on the bank's application form, but the bank also makes credit decisions based on oral requests, the bank's procedures are to accept both oral and written applications. Regulation B standards of what is considered an application under sections 1002.2(f) and 1002.9 are generally applicable to the definition of a covered application under Section 1071.

The term covered application does not include reevaluation, extension, or renewal of an existing business credit account, unless the request seeks additional credit amounts. For example, an applicant's request to extend the duration on a business line of credit or to remove a guarantor would not be a covered application. Conversely, an applicant's request for a line increase on an existing business line of credit, made in accordance with a bank's procedures for the type of credit requested, would be a covered application.

Additionally, the term covered application does not include evaluations or reviews of existing accounts initiated by the bank because the applicant has not made the request. For example, if a bank conducts periodic reviews of its existing business lines of credit and decides to increase the applicant's line by $10,000, it is not a covered application because the applicant never made a request for the additional credit amount. However, if such an evaluation or review of an existing account by a bank results in the bank inviting the applicant to apply for additional credit amounts on an existing account that is a covered credit transaction, and the applicant does so, the applicant's request constitutes a covered application.

Regarding inquiries and prequalification requests, under proposed Section 1071, an inquiry is a request by a prospective applicant for information about credit terms offered by the bank. A prequalification request is a request by a prospective applicant for a

February 2023
Volume 28, Number 9

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preliminary determination on whether the prospective applicant would likely qualify for credit under a bank's standards or for a determination on the amount of credit for which the prospective applicant would likely qualify. Inquiry and prequalification requests are not covered applications under Section 1071 data collection and reporting rules, even though in certain circumstances inquiries and prequalification requests may constitute applications under other areas of Regulation B rules.

What is Considered a Small Business, Women- or Minority-Owned Business

Once a bank determines that (1) CFPB's Section 1071 rule applies because it has originated at least 25 covered credit transactions for small businesses in each of the two preceding calendar years, and (2) it is working with an oral or written request for a business loan, line of credit, credit cards, and merchant cash advances (a covered credit transaction) and thereby has a covered application, the bank next need identify whether the covered application is from a women- or minority-owned business or small business applicant to then determine whether Section 1071-related data need be collected for reporting.

As proposed, Section 1071 defines "small business" to mean a business with a gross annual revenue of $5 million or less during the preceding fiscal year. The proposed rule sets forth conditions that banks are to consider if there is a change in the determination of an applicant's small business status during the course of underwriting and for how to consider applicant affiliate revenue.

A "women-owned business," as proposed, means a business for which more than 50% of its ownership or control is held by one or more women, and more than 50% of its net profits or losses accrue to one or more women.

Similarly, a "minority-owned business," as proposed, means a business for which more than 50% of its ownership or control is held by one or more minority individuals, and more than 50% of its net profits or losses accrue to one or more minority individuals. A minority individual means a natural person who is American Indian or Alaska Native, Asian, Black or African American, Native Hawaiian or Other Pacific Islander, and/or Hispanic or Latino. A natural person who is multi-racial or multi-ethnic is a minority individual under the Section 1071 proposal.

For both women-owned and minority-owned business definitions, both prongs of the definition need be met for the definition to apply. For example, a business is owned entirely by minority individuals, but not controlled by any minority individual satisfies the first prong of the definition. Second, 50% of more of net profits or losses must accrue to one or more minority individuals to satisfy the definition.

To consider what is ownership under the definition, a natural person owns a business if that natural person directly or indirectly has an equity interest in the business. For example, assume applicant is Company A. If Company B owns 60% of Company A and a natural person owns 100% of Company B, the natural person owns 60% of applicant Company A. Similarly, if a natural person directly owns 20% of applicant Company A and is an equal partner in Partnership B that owns the remaining 80% of applicant Company A, the natural person owns 60% of applicant Company A (20% through direct ownership, 40% indirectly through Partnership B).

To consider what is control and accrual of net profits and losses, a natural person controls a business if that person has significant responsibility to manage or direct the business. A natural person controls a business if the natural person is an executive officer or senior manager (*e.g.*, a chief executive officer, chief financial officer, chief operating officer, managing member, general partner, president, vice president, or treasurer) or regularly performs similar functions. Additionally, a business may be controlled by two or more minority individuals if those individuals collectively control the business, such as constituting a majority of the board of directors or a majority of the partners of a partnership.

A business' net profits and losses accrue to a natural person if that natural person receives the net profits or losses, is legally entitled or required to receive the net profit or losses, or is legally entitled or required to recognize the net profits or losses for tax purposes.

Apply the Data Collection Proposal to Bank Operations

Based upon the Section 1071 proposal, if the bank determines that Section 1071 will likely apply to the bank and that the bank handles applications for business credit from women- or minority-owned businesses or small businesses, the bank should begin to consider how it would collect data regarding such applications. Some data will likely be collected by loan processors or other loan operations persons involved in handling the application. A question for each bank to consider is that for each type of business credit request which may be taken, how will the bank identify it is working with a covered application, and how then will the bank collect Section 1071-related data for further reporting?

A reasonable place to begin is for the bank to identify how it accepts covered applications and how it would collect data related to the covered application. To help conceptualize the data potentially involved, the following items are the data CFPB has proposed be collected. Several of the data listed have multiple elements to be collected for the one data point listed:

- Unique identifier
- Application date
- Application method
- Application recipient
- Credit type
- Credit purpose
- Amount applied for
- Amount approved or originated
- Action taken
- Action taken date
- Denial reasons
- Pricing information
- Census tract
- Gross annual revenue
- NAICS code
- Number of workers
- Time in business
- Women-owned status
- Minority-owned status
- Ethnicity, race, and sex of principal owners
- Number of principal owners

So, referring back to opening questions of the article, what does the bank consider to be an application for business-purpose credit? Is it a verbal request? Is the request written? Can an application for business credit be made via email or via some other electronic method? What are the stated application procedures of the bank? What are the actual practices followed by the bank? Are there occasions when the bank makes credit decisions based upon oral requests even though the bank's stated policy states all applications be in writing?

For identified business credit application practices banks should start to consider how to identify when they are working with a covered application and how to potentially collect reportable data. For example, if the bank has an oral application subject to the rule, how will the bank collect Section 1071-related data—especially data not necessary for making credit decisions related to the covered application? How in the business credit application process will bank identify whether the applicant is a women- or minority-owned business, or a small business?

Conclusion

As the industry awaits the release of the expected final Section 1071 rule come March, banks should begin to identify how applications for business credit are accepted. By identifying its procedure, a bank can then begin to consider how it may identify when it is working with a covered application. Such preliminary steps can help lead a bank to consider how it may gather data CFPB will ultimately require be collected under the final rule.

Stay connected to WBA for future information and resources regarding Section 1071. Once finalized, WBA will have additional information to help members understand, navigate, and implement the requirements of the new rule.

The proposed Section 1071 rule may be viewed at: https://www.govinfo.gov/content/pkg/FR-2021-10-08/pdf/2021-19274.pdf

Current resources regarding the proposed rule may be found on the WBA Compliance website, under the section "Compliance Toolkits" located at: https://www.wisbank.com/resources/compliance/

Agency Guidance Regarding Lower Closed-End Mortgage Loan HMDA Reporting Threshold

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) each issued guidance regarding the recently lowered reporting threshold for closed-end mortgage loans under the Home Mortgage Disclosure Act (HMDA), Regulation C. The reduction of the reporting threshold was swiftly imposed, and the recently released agency guidance will be helpful for members impacted by the change.

As previously reported in the *WBA Compliance Journal*, the Bureau of Consumer Financial Protection (CFPB) lowered the reporting threshold due to an action by the United States District Court for the District of Columbia which vacated a 2020 HMDA-related rule that had increased the loan-volume reporting threshold for closed-end mortgage loans. As a result of the court's order, the threshold for reporting data about closed-end mortgage loans was lowered to 25, a threshold established by a 2015 HMDA-related rule. A technical amendment was made to the Code of Federal Regulations to reflect the lower reporting threshold near the end of 2022. Each agency's guidance is outlined below.

FRB Guidance, CA 23-1

In its release, FRB stated it recognizes that financial institutions affected by the change to the HMDA reporting threshold for closed-end mortgage loans may need time to implement or adjust policies and procedures, systems, and operations to come into compliance with their reporting obligations. FRB further provided that the Consumer Affairs (CA) letter serves as notice that, consistent with CFPB, FRB does not intent to cite HMDA violations or take enforcement action for not collecting or reporting closed-end mortgage loan data originated in 2022, 2021, or 2020 by FRB-supervised financial institutions 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. FRB CA 23-1 may be viewed at: www.federalreserve.gov/supervisionreg/caletters/CA%2023-1.pdf

FDIC Guidance, FIL 06-20203

In its release, FDIC outlined its supervisory approach to the HMDA reporting changes to closed-end mortgage loans. FDIC also stated recognition that banks affected by the threshold change need time to implement or adjust policies, procedures, systems, and operations to come into compliance with reporting obligations. Accordingly, for closed-end mortgage loan data, FDIC plans to implement a supervisory approach consistent with CFPB's approach. As such, for FDIC-supervised banks that are (1) subject to Regulation C's other coverage requirements, and (2) 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 of the two preceding calendar years, FDIC does not intend to initiate enforcement actions or cite HMDA violations for failures to report closed-end mortgage loan data for 2022, 2021, or 2020. Any FDIC-supervised bank may elect to report data voluntarily for those years, however, FDIC stated it does not expect those banks to collect and report data retroactively for closed-end mortgage loans covered by the court's order vacating CFPB's 2020 HMDA-related rule. FDIC has clarified that banks affected by the court's order, and that meet the reporting threshold of 25 closed-end mortgage loans in each of the two proceeding calendar years as of 2023, should start collecting data in 2023 and reporting data in 2024. FDIC FIL-06-2023 may be viewed at: www.fdic.gov/news/financial-institution-letters/2023/fil23006.html

OCC Guidance, Bulletin 2023-5

Similar to the other agencies, in its release OCC acknowledged that banks which 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, may need to make adjustments to policies and procedures to comply with reporting obligations. OCC also stated it recognizes the changes may require time to implement. OCC does not intend to assess penalties for failures to report closed-end mortgage loan data on reportable transactions conducted in 2022, 2021, or 2020 for banks affected by the change that meet Regulation C's other coverage requirements. OCC examinations conducted in affected banks regarding HMDA reportable transactions from 2022, 2021, or 2020 will be diagnostic to help banks identify compliance weaknesses. OCC stated that the collection and submission of 2023 HMDA data will provide affected banks with an opportunity to identify gaps in and make improvements to their HMDA compliance management systems. OCC Bulletin 2023-5 may be viewed at: www.occ.gov/news-issuances/bulletins/2023/bulletin-2023-5.html

Conclusion

As is always the case, when working with regulatory agencies, WBA recommends frank conversations with your examiner in charge (EIC) regarding agency expectations and findings. While being respectful, members should not be shy about questioning the EIC about examiners' rationale or interpretations and to ask for regulatory citations for the bank to then separately, further research and confirm whether examiner instruction or finding is correct. The recently released agency guidance will be helpful for members impacted by the change.

If you have questions regarding the recently issued guidance, about HMDA reporting requirements, or other compliance-related questions, be sure to reach out to the WBA Legal team at wbalegal@wisbank.com or at 608-441-1200.

New WBA-Created Flood Insurance and Transfer by Affidavit Resources Available

In an effort to continue to provide new resources through WBA's compliance page, two new free resources have recently become available. WBA has created and released a Flood Insurance Toolkit and Transfer by Affidavit Guide. While there are no new rules or regulation in either area, both are topics of frequent questions received through the WBA Legal Call Program. WBA created the resources to serve as broad guides, designed to assist not only in answering frequent questions, but also to present both topics in a more readily understandable light. Both resources include the basics of each topic, along with notes, flow charts, and instructions. Additionally, the resources can serve as excellent training materials for new staff.

Flood Insurance Toolkit

While the rules governing the mandatory purchase of flood insurance are not new, there are nuances to the rules which frequently go overlooked. The WBA Flood Insurance Toolkit is designed to help bankers understand the flood insurance rules in full, consider policy-specific aspects, and to help train staff. The toolkit starts with the full rule, but breaks it down in a manner that is easy to understand, along with policy tips to help users identify bank-specific procedures.

In addition, the Toolkit includes a flow chart to assist in determining when the flood insurance rules apply, an article covering cross-collateralization considerations, and select Q&As to assist in understanding more nuanced aspects of the rules. Included alongside the Toolkit is a separate word document featuring three checklists. The checklists are provided separately so that users can modify them to suit their individual needs based upon bank-specific tasks performed by lenders, processors or underwriters, and audit or compliance individuals. Additionally, a flood insurance amount calculator is provided in the form of an Excel document, which includes instructions and formulas to help determine what coverage is required. Taken together, the Toolkit makes for an excellent way to evaluate a bank's flood insurance procedures and train new staff to help ensure the bank has robust flood insurance policies.

Wisconsin Bankers ASSOCIATION

Compliance Journal
January 2023

Special Focus

FDIC's Revised Guidelines for Appeals of Material Supervisory Determinations

The Federal Deposit Insurance Corporation (FDIC) recently adopted revised Guidelines for Appeals of Material Supervisory Determinations (Guidelines). The revisions expand and clarify the role of FDIC's Ombudsman, add the Ombudsman to the Supervision Appeals Review Committee as a non-voting member, and require that materials considered by the Supervision Appeals Review Committee be shared with both parties to the appeal on a timely basis, subject to applicable legal limitations on disclosure. In addition, the revised Guidelines allow insured depository institutions to request a stay of a material supervisory determination while an appeal is pending. Insured depository institutions (IDIs) should know the process and timelines associated with the revised Guidelines to effectively file an appeal should the need arise. The revised Guidelines are effective **December 13, 2022**.

The Guidelines apply to IDIs that FDIC supervises (*i.e.*, insured State nonmember banks, insured branches of foreign banks, and state savings associations), and to other IDIs for which FDIC makes material supervisory determinations.

Introduction

Section 309(a) of the Riegle Community Development and Regulatory Improvement Act required FDIC to establish an independent intra-agency appellate process to review material supervisory determinations made at IDIs that it supervises. The Guidelines describe the types of determinations that are eligible for review and the process by which appeals will be considered and decided. The procedures set forth in the Guidelines establish an appeals process for the review of material supervisory determinations by the Supervision Appeals Review Committee (SARC).

SARC Membership

The following individuals comprise the three (3) voting members of SARC: (1) One inside FDIC Board member, either the Chairperson, the Vice Chairperson, or the FDIC Director (Appointive), as designated by the FDIC Chairperson (this person would serve as the Chairperson of SARC); and (2) one deputy or special assistant to each of the inside FDIC Board members who are not designated as SARC Chairperson. The General Counsel and the Ombudsman are non-voting members of SARC.

The FDIC Chairperson may designate alternate member(s) to SARC if there are vacancies so long as the alternate member was not involved in making or affirming the material supervisory determination under review. A member of SARC may designate and authorize a member of his or her staff within the member's area of responsibility related to cases before SARC to act on his or her behalf.

Determinations Subject to Appeal

An IDI may appeal any material supervisory determination pursuant to the procedures set forth in the Guidelines. Under the Guidelines, a material supervisory determination includes:

- CAMELS ratings under the Uniform Financial Institutions Rating System;
- IT ratings under the Uniform Rating System for Information Technology;

- Trust ratings under the Uniform Interagency Trust Rating System;
- CRA ratings under the Revised Uniform Interagency Community Reinvestment Act Assessment Rating System;
- Consumer compliance ratings under the Uniform Interagency Consumer Compliance Rating System;
- Registered transfer agent examination ratings;
- Government securities dealer examination ratings;
- Municipal securities dealer examination ratings;
- Determinations relating to the appropriateness of loan loss reserve provisions;
- Classifications of loans and other assets in dispute the amount of which, individually or in the aggregate, exceeds 10 percent of an IDI's total capital;
- Determinations relating to violations of a statute or regulation that may affect the capital, earnings, or operating flexibility of an IDI, or otherwise affect the nature and level of supervisory oversight accorded an IDI;
- Truth in Lending Act (Regulation Z) restitution;
- Filings made pursuant to 12 CFR 303.11(f), for which a request for reconsideration has been granted, other than denials of a change in bank control, change in senior executive officer or board of directors, or denial of an application pursuant to section 19 of the Federal Deposit Insurance Act (FDI Act), 12 U.S.C. 1829 (which are contained in 12 CFR 308, subparts D, L, and M, respectively), if the filing was originally denied by the Director, Deputy Director, or Associate Director of the Division of Depositor and Consumer Protection (DCP) or the Division of Risk Management Supervision (RMS);
- Decisions to initiate informal enforcement actions (such as memoranda of understanding);
- Determinations regarding IDI's level of compliance with a formal enforcement action; however, if FDIC determines that the lack of compliance with an existing formal enforcement action requires an additional formal enforcement action, the proposed new enforcement action is not appealable;
- Matters requiring board attention; and
- Any other supervisory determination (unless otherwise not eligible for appeal) that may affect the capital, earnings, operating flexibility, or capital category for prompt corrective action purposes of an IDI, or that otherwise affects the nature and level of supervisory oversight accorded an IDI.

The following are activities which are not considered material supervisory determinations under the Guidelines:

- Decisions to appoint a conservator or receiver for an IDI, and other decisions made in furtherance of the resolution or receivership process, including but not limited to determinations pursuant to parts 370, 371, and 381, and section 360.10 of FDIC's rules and regulations;
- Decisions to take prompt corrective action pursuant to section 38 of the FDI Act, 12 U.S.C. 1831o;
- Determinations for which other appeals procedures exist (such as determinations of deposit insurance assessment risk classifications and payment calculations); and
- Formal enforcement-related actions and decisions, including determinations and the underlying facts and circumstances that form the basis of a recommended or pending formal enforcement action.

Formal Enforcement-Related Action or Decisions

A formal enforcement-related action or decision commences, and becomes unappealable, when FDIC initiates a formal investigation under 12 U.S.C. 1820(c) (Order of Investigation), issues a notice of charges or a notice of assessment under 12 U.S.C. 1818

January 2023
Volume 28, Number 8

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or other applicable laws (Notice of Charges), provides an IDI with a draft consent order, or otherwise provides written notice to an IDI that FDIC is reviewing the facts and circumstances presented to determine if a formal enforcement action is merited under applicable statutes or published enforcement-related policies of FDIC, including written notice of a referral to the Attorney General pursuant to the Equal Credit Opportunity Act (ECOA) or a notice to the Secretary of Housing and Urban Development (HUD) for violations of ECOA or the Fair Housing Act (FHA). Such notice may be provided in the transmittal letter accompanying a Report of Examination.

For the purposes of the Guidelines, remarks in a Report of Examination do not constitute written notice that FDIC is reviewing the facts and circumstances presented to determine if a proposed enforcement action is merited. Commencement of a formal enforcement-related action or decision will not suspend or otherwise affect a pending request for review or appeal that was submitted before the commencement of the formal enforcement-related action or decision.

Additional Appeal Rights

In the case of any written notice from FDIC to an IDI that FDIC is determining whether a formal enforcement action is merited, FDIC must issue an Order of Investigation, issue a Notice of Charges, or provide the IDI with a draft consent order within 120 days of such a notice, or the most recent submission of information from the IDI, whichever is later, or appeal rights will be made available pursuant to the Guidelines. If FDIC timely provides an IDI with a draft consent order and the IDI rejects the draft consent order in writing, FDIC must issue an Order of Investigation or a Notice of Charges within 90 days from the date on which the IDI rejects the draft consent order in writing, or appeal rights will be made available pursuant to the Guidelines. The FDIC may extend these periods, with the approval of the SARC Chairperson, after FDIC notifies the IDI that the relevant Division Director is seeking formal authority to take an enforcement action.

In the case of a referral to the Attorney General for violations of ECOA, beginning on the date the referral is returned to FDIC, FDIC must proceed in accordance with the requirements outlined in the preceding paragraph, including within the specified timeframes, or appeal rights will be made available pursuant to the Guidelines. The same process is to be followed for a case involving notice to HUD for violations of ECOA or FHA.

Written notification will be provided to an IDI within 10 days of a determination that appeal rights have been made available. The relevant FDIC Division and IDI may mutually agree to extend the timeframes outlined, if the parties deem it appropriate.

Good-Faith Resolution

The Guidelines provide that an IDI should make a good-faith effort to resolve any dispute concerning a material supervisory determination with the on-site examiner and/or the appropriate Regional Office. The on-site examiner and the Regional Office will promptly respond to any concerns raised by an IDI regarding a material supervisory determination. Informal resolution of disputes with the on-site examiner and the appropriate Regional Office is encouraged; however, seeking such a resolution is not a condition to filing a request for review with the appropriate Division, either DCP, RMS, or the Division of Complex Institution Supervision and Resolution (CISR), or to filing a subsequent appeal with SARC under the Guidelines.

Filing a Request for Review With the Appropriate Division

An IDI may file a request for review of a material supervisory determination with the Division that made the determination, either the Director, DCP, RMS, or CISR (Director or Division Director), 550 17th Street NW, Room F-4076, Washington, DC 20429, within 60 calendar days following the IDI's receipt of a report of examination containing a material supervisory determination or other written communication of a material supervisory determination. Requests for review also may be submitted electronically. To ensure confidentiality, requests should be submitted through *securemail.fdic.gov*, directing the message to *DirectorReviewRequest@fdic.gov.*

A request for review must be in writing and must include:

- A detailed description of the issues in dispute, the surrounding circumstances, the IDI's position regarding the

dispute and any arguments to support that position (including citation of any relevant statute, regulation, policy statement, or other authority), how resolution of the dispute would materially affect the IDI, and whether a good-faith effort was made to resolve the dispute with the on-site examiner and the Regional Office; and
- A statement that the IDI's board of directors or senior management has considered the merits of the request and has authorized that it be filed. Senior management is defined as the core group of individuals directly accountable to the board of directors for the sound and prudent day-to-day management of the IDI. If an IDI's senior management files an appeal, it must inform the board of directors of the substance of the appeal before filing and keep the board of directors informed of the appeal's status.

Within 45 calendar days after receiving a request for review as described above, the Division Director will: (a) review the appeal, considering whether the material supervisory determination is consistent with applicable laws, regulations, and policy, make his or her own supervisory determination without deferring to the judgments of either party, and issue a written determination on the request for review, setting forth the grounds for that determination; or (b) refer the request for review to SARC for consideration as an appeal under the Guidelines and provide written notice to the IDI that the request for review has been referred to SARC.

No appeal to SARC will be allowed unless an IDI has first filed a timely request for review with the appropriate Division Director. In any decision issued by the Division Director, the Director will inform the IDI of the 30-day time period for filing with SARC and will provide the mailing address for any appeal the IDI may wish to file. The Division Director may request guidance from the SARC Chairperson or the Legal Division as to procedural or other questions relating to any request for review.

Appeal to SARC

An IDI that does not agree with the written determination rendered by the Division Director may appeal that determination to SARC within 30 calendar days after the date of receipt of that determination. Failure to file within the 30-day time limit may result in denial of the appeal by SARC.

Filing With SARC

An appeal to SARC will be considered filed if the written appeal is received by FDIC within 30 calendar days after the date of receipt of the Division Director's written determination or if the written appeal is placed in the U.S. mail within that 30-day period. The appeal should be sent to the address indicated on Division Director's determination being appealed, or sent via email to ESS_Appeals@fdic.gov. An acknowledgment of the appeal will be provided to the IDI, and copies of the IDI's appeal will be provided to the Office of the Ombudsman and appropriate Division Director. Copies of all relevant materials related to an appeal will be provided to the Office of the Ombudsman.

Contents of Appeal

The appeal should be labeled to indicate that it is an appeal to SARC and should contain the name, address, and telephone number of the IDI and any representative, as well as a copy of the Division Director's determination being appealed. If oral presentation is sought, that request should be included in the appeal. If expedited review is requested, the appeal should state the reason for the request. Only matters submitted to the appropriate Division Director in a request for review may be appealed to SARC.

Evidence not presented for review to the Division Director is generally not permitted; such evidence may be submitted to SARC only if approved by the SARC Chairperson and with a reasonable time for the Division Director to review and respond. The IDI should set forth all of the reasons, legal and factual, why it disagrees with the Division Director's determination. Nothing in the SARC administrative process shall create any discovery or other such rights.

Burden of Proof

The burden of proof as to all matters at issue in the appeal, including timeliness of the appeal if timeliness is at issue, rests with the IDI.

Submission From the Division Director

The Division Director may submit views regarding the appeal to SARC within 30 calendar days of the date on which the appeal is received by SARC.

Oral Presentation

The SARC will, if a request is made by the IDI or by FDIC staff, allow an oral presentation. The SARC may hear oral presentations in person, telephonically, electronically, or through other means agreed upon by the parties. If an oral presentation is held, the IDI and FDIC staff will be allowed to present their positions on the issues raised in the appeal and to respond to any questions from SARC.

Consolidation, Dismissal, and Rejection

Appeals based upon similar facts and circumstances may be consolidated for expediency. An appeal may be dismissed by SARC if it is not timely filed, if the basis for the appeal is not discernable from the appeal, or if the IDI moves to withdraw the appeal. The SARC will decline to consider an appeal if an IDI's right to appeal is not yet available under the additional appeal rights outlined above.

Scope of Review and Decision

The SARC will be an appellate body and will make independent supervisory determinations. The SARC will review the appeal for consistency with the policies, practices, and mission of FDIC and the overall reasonableness of, and the support offered for, the positions advanced. The SARC's review will be limited to the facts and circumstances as they existed prior to, or at the time the material supervisory determination was made, even if later discovered, and no consideration will be given to any facts or circumstances that occur or corrective action taken after the determination was made. The SARC will not consider any aspect of an appeal that seeks to change or modify existing FDIC rules or policy. The SARC, after consultation with the Legal Division, will refer any appeals that raise policy matters of first impression to the Chairperson's Office for its consideration. The SARC will notify the IDI, in writing, of its decision concerning the disputed material supervisory determination(s) within 45 days after the date SARC meets to consider the appeal, which meeting will be held within 90 days after either the date of the filing of the appeal or the date that Division Director refers the appeal to SARC.

Other Communications

Materials considered by SARC will be shared with both parties to the appeal, subject to applicable legal limitations on disclosure, on a timely basis. The Ombudsman will verify that both parties have received all materials considered by SARC.

Publication of Decisions

Decisions of SARC will be published as soon as practicable, and the published decisions will be redacted to avoid disclosure of the name of the appealing IDI and any information exempt from disclosure under the Freedom of Information Act and FDIC's document disclosure regulations found in 12 CFR part 309. In cases in which redaction is deemed insufficient to prevent improper disclosure, published decisions may be presented in summary form. Published SARC decisions may be cited as precedent in appeals to SARC. Annual reports on SARC's decisions and Division Directors' decisions with respect to IDIs' requests for review of material supervisory determinations also will be published.

Appeal Guidelines Generally

Appeals to SARC will be governed by the Guidelines. The SARC, with the concurrence of the Legal Division, will retain discretion to waive any provision of the Guidelines for good cause. Supplemental rules governing SARC's operations may be adopted.

An IDI may request extensions of the time period for submitting appeals under the Guidelines from either the appropriate Division Director or the SARC Chairperson, as appropriate. If a filing under the Guidelines is due on a Saturday, Sunday, or a Federal holiday, the filing may be made on the next business day.

An IDI may request a stay of a supervisory action or determination from the Division Director while an appeal of that determination is pending. The request must be in writing and include the reason(s) for the stay. The Division Director has discretion to grant a stay and will generally decide whether to grant a stay within 21 days of receiving an IDI's request, providing the IDI with the reason(s) for his or her decision in writing. A stay may be granted subject to conditions, including time limitations, where appropriate.

Coordination with State Regulatory Authorities

In the event that a material supervisory determination subject to a request for review is the joint product of FDIC and a State regulatory authority (WDFI), the Director, DCP, RMS, or CISR, as appropriate, will promptly notify WDFI of the request, provide WDFI with a copy of the IDI's request for review and any other related materials, and solicit WDFI's views regarding the merits of the request before making a determination. In the event that an appeal is subsequently filed with SARC, SARC will notify the IDI and WDFI of its decision. Once SARC has issued its determination, any other issues that may remain between the IDI and WDFI will be left to those parties to resolve.

Effect on Supervisory or Enforcement Actions

The use of the procedures set forth in the Guidelines by an IDI will not affect, delay, or impede any formal or informal supervisory or enforcement action in progress during the appeal or affect FDIC's authority to take any supervisory or enforcement action against that IDI.

Effect on Applications or Requests for Approval

Any application or request for approval made to FDIC by an IDI that has appealed a material supervisory determination that relates to, or could affect the approval of, the application or request will not be considered until a final decision concerning the appeal is made unless otherwise requested by the IDI.

Prohibition on Examiner Retaliation

The FDIC has an experienced examination workforce and is proud of its professionalism and dedication. FDIC policy prohibits any retaliation, abuse, or retribution by an FDIC examiner or any FDIC personnel against an IDI. Such behavior against an IDI that appeals a material supervisory determination constitutes unprofessional conduct and will subject the examiner or other personnel to appropriate disciplinary or remedial action. In light of this important principle, the Ombudsman will monitor the supervision process following an IDI's submission of an appeal under the Guidelines. The Ombudsman will report to the FDIC Board on these matters periodically. Any IDI that believes they have been retaliated against are encouraged to contact the Regional Director for the appropriate FDIC region. Any IDI that believes or has any evidence that it has been subject to retaliation may file a complaint with the Director, Office of the Ombudsman, Federal Deposit Insurance Corporation, 3501 Fairfax Drive, Suite E-2022, Arlington, VA 22226, explaining the circumstances and the basis for such belief or evidence and requesting that the complaint be investigated, and appropriate disciplinary or remedial action taken. The Office of the Ombudsman will work with the appropriate Division Director to resolve the allegation of retaliation.

Conclusion

While IDIs are to make good-faith efforts to resolve any dispute concerning a material supervisory determination with the on-site examiner and/or the appropriate Regional Office, IDIs should know of the rights and procedures set forth within the revised Guidelines in the event an appeal of a material supervisory determination need be filed.

The Guidelines may be viewed at: www.govinfo.gov/content/pkg/FR-2022-12-16/pdf/2022-27351.pdf

2023 Adjusted State and Federal Regulatory Thresholds and Limits

Happy New Year! As we step into 2023, there are several thresholds which have been adjusted by both state and federal regulators which go into effect now that the new year has arrived. Below is a collection of thresholds effective **January 1, 2023**, including a link to pull each publication for reference.

Regulation Z, TILA

- The exemption threshold for Regulation Z (Truth in Lending Act) will increase to **$66,400**, up from $61,000. www.govinfo.gov/content/pkg/FR-2022-10-20/pdf/2022-22819.pdf

- The exemption threshold for Regulation M (Consumer Leasing Act) will increase to **$66,400**, up from $61,000. www.govinfo.gov/content/pkg/FR-2022-10-20/pdf/2022-22818.pdf

- The exemption threshold under Regulation Z for HPML appraisals will increase to **$31,000**, up from $28,500. www.govinfo.gov/content/pkg/FR-2022-10-20/pdf/2022-22820.pdf

- The asset-size threshold under Regulation Z which exempts creditors from the requirement to establish an escrow account for HPMLs will be:
    - For creditors and their affiliates that regularly extended covered transactions secured by first liens, the asset-size threshold is adjusted to **$2.537 billion**, up from $2.336 billion; and
    - The exemption threshold for certain insured depository institutions with assets of $10 billion or less is adjusted to **$11.374 billion**, up from $10.473 billion. www.govinfo.gov/content/pkg/FR-2022-12-30/pdf/2022-28439.pdf

- The dollar amount thresholds under Regulation Z for HOEPA and QM-related loans have been adjusted as follows:
    - For HOEPA loans, the adjusted total loan amount threshold for high-cost mortgages will be **$24,866**.
    - The adjusted points-and-fees dollar trigger for high-cost mortgages will be **$1,243**.

    - For QMs under the General QM loan definition in § 1026.43(e)(2), the thresholds for the spread between the annual percentage rate (APR) and the average prime offer rate (APOR) will be:
        - 2.25 or more percentage points for a first-lien covered transaction with a loan amount greater than or equal to **$124,331**;
        - 3.5 or more percentage points for a first-lien covered transaction with a loan amount greater than or equal to **$74,599** but less than **$124,331**;
        - 6.5 or more percentage points for a first-lien covered transaction with a loan amount less than **$74,599**;
        - 6.5 or more percentage points for a first-lien covered transaction secured by a manufactured home with a loan amount less than **$124,331**;
        - 3.5 or more percentage points for a subordinate-lien covered transaction with a loan amount greater than or equal to **$74,599**; or
        - 6.5 or more percentage points for a subordinate-lien covered transaction with a loan amount less than **$74,599**.

    - For all categories of QMs, the thresholds for total points and fees will be:
        - 3 percent of the total loan amount for a loan greater than or equal to **$124,331**;
        - **$3,730** for a loan amount greater than or equal to **$74,599** but less than **$124,331**;
        - 5 percent of the total loan amount for a loan greater than or equal to **$24,866** but less than **$74,599**;
        - **$1,243** for a loan amount greater than or equal to **$15,541** but less than **$24,866**; and
        - 8 percent of the total loan amount for a loan amount less than **$15,541**.

    - For open-end consumer credit plans under TILA, the threshold that triggers requirements to disclose minimum interest charges will remain unchanged at **$1.00**. www.govinfo.gov/content/pkg/FR-2022-12-23/pdf/2022-28023.pdf

Regulation C, HMDA

- The asset-size threshold to be exempt from collecting HMDA data in 2023 is adjusted to **$54 million**, up from $50 million. www.govinfo.gov/content/pkg/FR-2022-12-30/pdf/2022-28441.pdf

Community Reinvestment Act (CRA)

- The Board of Governors of the Federal Reserve System (FRB) and Federal Deposit Insurance Corporation (FDIC) CRA regulations have adjusted the asset-size thresholds used to define "small bank" and "intermediate small bank" to be:
    - Small bank means a bank that, as of December 31 of either of the prior two calendar years, had assets of less than **$1.503 billion**; and
    - Intermediate small bank means a small bank with assets of at least **$376 million** as of December 31 of both of the prior two calendar years and less than **$1.503 billion** as of December 31 of either of the prior two calendar years. www.govinfo.gov/content/pkg/FR-2022-12-23/pdf/2022-27922.pdf

- The Office of the Comptroller of the Currency (OCC) made the identical adjustments to the asset-size thresholds used to define "small bank or savings association" and "intermediate small bank or savings association." www.occ.treas.gov/news-issuances/bulletins/2022/bulletin-2022-28.html

Required Escrow Rate under Wisconsin Law

- The Wisconsin Department of Financial Institutions (WDFI) has established the interest rate that must be paid on required escrow accounts under section 138.052(5) of the Wisconsin Statutes. The new rate is **0.11%**. www.wdfi.org/_resources/indexed/site/fi/banks/EscrowNotice.pdf

Other Regulatory Thresholds and Limits

- The dollar amount of the maximum allowable charge for disclosures by a consumer reporting agency to a consumer pursuant to Fair Credit Report Act (FCRA) section 609 for the 2023 calendar year is **$14.50**. www.govinfo.gov/content/pkg/FR-2022-11-25/pdf/2022-25751.pdf

- The FDIC Designated Reserve Ratio remains **2 percent** for 2023. www.govinfo.gov/content/pkg/FR-2022-10-24/pdf/2022-22987.pdf

- The OCC assessment rates are reduced for the general assessment fee schedule. OCC has maintained assessment rates from 2022 for the independent trust and independent credit card fee schedules. Also, there is no inflation adjustment to assessment rates. www.occ.gov/news-issuances/news-releases/2022/nr-occ-2022-145.html

- Contribution limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is increased to **$22,500**, up from $20,500. The limit on annual contributions to an IRA increased to **$6,500**, up from $6,000. www.irs.gov/newsroom/401k-limit-increases-to-22500-for-2023-ira-limit-rises-to-6500

- Multifamily loan purchase caps for Fannie Mae and Freddie Mac will be **$75 billion** for each enterprise, for a combined total of $150 billion. The caps reflect an anticipated contraction of the multifamily originations market this year. FHFA will require that at least 50 percent of Fannie's and Freddie's multifamily business be mission-driven affordable housing. www.fhfa.gov//Media/PublicAffairs/Pages/FHFA-Announces-2023-Multifamily-Loan-Purchase-Caps-for-Fannie-Mae-and-Freddie-Mac.aspx

- The conforming loan limit values for mortgages to be acquired by Fannie Mae and Freddie Mac in 2023 for one-unit properties will be **$726,200**, an increase from $647,200. www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Conforming-Loan-Limits-for-2023.aspx

- New loan limits for FHA's Single Family Title II Forward and Home Equity Conversion Mortgage (HECM) insurance programs, based upon property size and location, range from **$472,030** to **$3,142,800**. www.hud.gov/press/press_releases_media_advisories/HUD_No_22_244

- Beginning January 1, 2023, the standard IRS mileage rates for the use of a car (also vans, pickups or panel trucks) will be as follows. The rates apply to electric and hybrid-electric automobiles, as well as gasoline and diesel-powered vehicles.
    - **65.5 cents** per mile driven for business use, up 3 cents from the midyear increase setting the rate for the second half of 2022;
    - **22 cents** per mile driven for medical or moving purposes for qualified active-duty members of the Armed Forces, consistent with the increased midyear rate set for the second half of 2022; and
    - **14 cents** per mile driven in service of charitable organizations; the rate is set by statute and remains unchanged from 2022.

    www.irs.gov/newsroom/irs-issues-standard-mileage-rates-for-2023-business-use-increases-3-cents-per-mile

Joint Statement on Crypto-Asset Risks to Banking Organizations

On **January 3, 2023**, 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 statement regarding crypto-asset risks to banks. By “crypto-asset” the agencies generally mean any digital asset implemented using cryptographic techniques.

Banks engaged in crypto-asset-related activities need work closely with their state and federal regulators given the recent activities involving the crypto-asset sector and the agencies’ heightened focus on risks associated with such activity. Additional agency-issued resources are provided at the end of the article.

Given the crypto-asset-related events which occurred in 2022, the agencies identified a number of key risks associated with the crypto-asset sector that the agencies believe banks should be aware of, including:

- Risk of fraud and scams among crypto-asset sector participants.
- Legal uncertainties related to custody practices, redemptions, and ownership rights, some of which are currently the subject of legal processes and proceedings.
- Inaccurate or misleading representations and disclosures by crypto-asset companies, including misrepresentations regarding federal deposit insurance, and other practices that may be unfair, deceptive, or abusive, contributing to significant harm to retail and institutional investors, customers, and counterparties.
- Significant volatility in crypto-asset markets, the effects of which include potential impacts on deposit flows associated with crypto-asset companies.
- Susceptibility of stablecoins to run risk, creating potential deposit outflows for banks that hold stablecoin reserves.
- Contagion risk within the crypto-asset sector resulting from interconnections among certain crypto-asset participants, including through opaque lending, investing, funding, service, and operational arrangements. These interconnections may also present concentration risks for banks with exposures to the crypto-asset sector.
- Risk management and governance practices in the crypto-asset sector exhibiting a lack of maturity and robustness.
- Heightened risks associated with open, public, and/or decentralized networks, or similar systems, including, but not limited to, the lack of governance mechanisms establishing oversight of the system; the absence of contracts or standards to clearly establish roles, responsibilities, and liabilities; and vulnerabilities related to cyber-attacks, outages, lost or trapped assets, and illicit finance.

The agencies state that it is important that risks related to the crypto-asset sector that cannot be mitigated or controlled do not migrate to the banking system. The agencies state they are supervising banks that may be exposed to risks stemming from the crypto-asset sector and are carefully reviewing any proposals from banks to engage in activities that involve crypto-assets.

The agencies state that through their current case-by-case approach, they continue to build knowledge, expertise, and understanding of the risks crypto-assets may pose to banks, their customers, and the broader U.S. financial system. Given the significant risks highlighted by the recent failures of several large crypto-asset companies, the agencies continue to take careful and cautious approaches related to current or proposed crypto-asset-related activities and exposures at each bank.

The joint statement further reiterates that banks are neither prohibited nor discouraged from providing banking services to customers of any specific class or type, as permitted by law or regulation. The agencies state they continue to assess whether or how current and proposed crypto-asset-related activities by banks can be conducted in a manner that adequately addresses safety and soundness, consumer protection, legal permissibility, and compliance with applicable laws and regulations, including anti-money laundering and illicit finance statutes and rules.

Of significance, within the joint statement, the agencies stated that based on their current understanding and experience to date, the agencies believe that issuing or holding as principal crypto-assets that are issued, stored, or transferred on an open, public, and/or decentralized network, or similar system is highly likely to be inconsistent with safe and sound banking practices.

Further, the agencies have significant safety and soundness concerns with business models that are concentrated in crypto-asset-related activities or have concentrated exposures to the crypto-asset sector.

The agencies stated they will continue to closely monitor crypto-asset-related exposures of banks and as warranted, will issue additional statements related to engagement by banks in crypto-asset-related activities. The agencies also will continue to engage and collaborate with other relevant authorities, as appropriate, on issues arising from activities involving crypto-assets.

Each agency has developed processes whereby banks engage in robust supervisory discussions regarding proposed and existing crypto-asset-related activities. Banks should ensure that crypto-asset-related activities can be performed in a safe and sound manner, are legally permissible, and comply with applicable laws and regulations, including those designed to protect consumers (such as fair lending laws and prohibitions against unfair, deceptive, or abusive acts or practices). Banks should ensure appropriate risk management, including board oversight, policies, procedures, risk assessments, controls, gates and guardrails, and monitoring, to effectively identify and manage risks.

Resources:

As mentioned above, banks engaged in crypto-asset-related activities need work closely with their state and federal regulators given the recent activities involving the crypto-asset sector and the agencies' heightened focus on risks associated with such activity. The following is a list of processes the agencies expect banks to follow when looking to engage in crypto-asset-related activities:

OCC Interpretive Letter 1179, "Chief Counsel's Interpretation Clarifying: (1) Authority of a Bank to Engage in Certain Cryptocurrency Activities; and (2) Authority of the OCC the Charter a National Trust Bank," (November 18, 2021): www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1179.pdf

Federal Reserve SR 22-6/CA 22-6, "Engagement in Crypto-Asset-Related Activities by Federal-Reserve-Supervised Banking Organizations," (August 16, 2022): www.federalreserve.gov/supervisionreg/srletters/SR2206.htm

FDIC FIL-16-2022, "Notification and Supervisory Feedback Procedures for FDIC-Supervised Institutions Engaging in Crypto-Related Activities," (April 7, 2022): www.fdic.gov/news/financial-institution-letters/2022/fil22016.html#letter

Joint Statement on Crypto-Asset Risks to Banking Organizations: www.fdic.gov/news/press-releases/2023/pr23002a.pdf