STEVE H. POWELL & COMPANY
BANKING ON A SOLID FOUNDATION

COMPLIANCE PIPELINE

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TILA-RESPA Integrated Disclosure Rule: Top Five Things You Need to Know

On August 1, 2015, the long awaited TILA-RESPA Integrated Disclosure rule (TILA-RESPA rule) will go into effect. The TILA-RESPA rule is clearly a game changer for community banks and time is of the essence when implementing the steps necessary to ensure a financial institution is prepared by the effective date. The TILA-RESPA rule consolidates the existing early disclosures and closing disclosures required by TILA and RESPA into two new forms – the Loan Estimate and the Closing disclosure. In consolidating the disclosures, the CFPB borrowed some concepts from the existing regulations, added some new twists, and created new requirements based upon its consumer focused research.

The final rule also provides a detailed explanation of how the forms should be filled out and used. The TILA-RESPA rules will fundamentally change the mortgage origination and closing processes and requirements for completing these new forms are very complex. Much is at stake in complying with these rules, and errors may prove to be costly in the form of reimbursable violations.

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Steve H. Powell & Company Welcomes a New Team Member!

We would like to welcome Steve Shepherd as the newest member to the Steve H. Powell and Company Compliance team. Steve brings almost 15 years of compliance experience working for larger financial institutions and community banks.

Steve started his banking career almost 15 years ago at First National Bank of Nebraska working in the Internal Audit department and facilitating special projects. Later, Steve became the Senior Compliance Auditor for American National Bank, where he managed their internal compliance committee. Before moving to Georgia, Steve was also a Compliance Officer for Foundation One, a de novo Bank located in Omaha, Nebraska.

Steve holds the Certified Regulatory Manager Certification and is a member of the American Bankers Association, Institute of Certified Bankers. His educational background is comprised of a Masters in Business Administration and a Bachelor's degree in accounting.

Steve moved to Georgia with his wife Mariana, who teaches at Georgia Southern University. Steve and Mariana have recently welcomed a new daughter Claire.

Inside this issue:

CFPB Finalizes Consumer Complaint Policy

Everyone should know the importance of an effective consumer complaint management process. Complaints can reveal inaccurate disclosures, unclear marketing strategies, and even UDAAP concerns. Now, the CFPB has raised the stakes even higher by allowing consumers to post their account of the complaint in the CFPB's public Consumer Complaint Database. Currently the Consumer Complaint Database only contains basic information about the complaint. However, the new format will provide consumers an opportunity to opt into sharing their narrative of the complaint. The CFPB's only qualification for allowing the dissemination of the narrative is that it has to be submitted via the website and the complainant has a verified relationship with the bank.

Financial institutions will have 180 days to respond publically to the compliant but responding publically is optional. In a recent letter, the ABA urged changes to the finalized policy that would help provide context and eliminate certain complaints of which banks were not responsible. The CFPB is scheduled to start posting the narrative complaints on May 18th. It is recommended that financial institutions have policy and procedures in place for responding to negative complaints reported to the CFPB. Significant reputational damage can occur if an institution isn't diligent in handling public complaints.

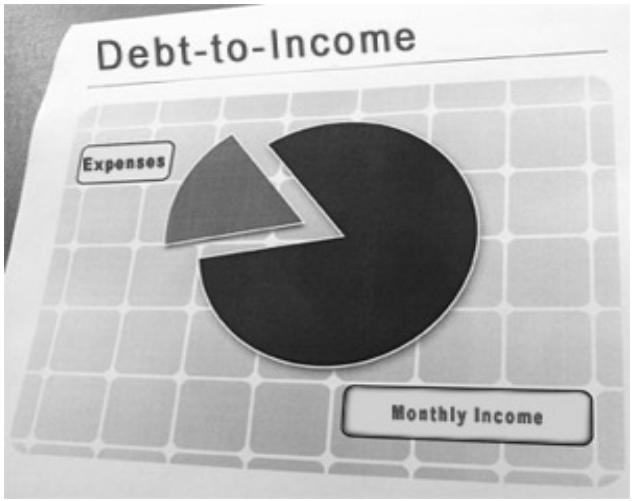
Nontaxable Income Concerns with Fair Lending

Recently, there has been confusion among bankers about the "grossing up" of income derived from nontaxable sources. The "grossing up" of income is the practice of applying an adjustment to applicant income to increase the value of the borrower's income in underwriting. Grossing up net income is necessary to treat applicants similarly when underwriting based on gross income.

The Joint Agencies "Policy Statement on Discrimination in Lending" from April 1994 states that lenders who utilize a gross income DTI calculation for underwriting and treat taxable and non-taxable income the same in regards to DTI are at risk for evidence of disparate impact. Noting that, by not treating taxable and non-taxable income differently "the lender's policy may have a disparate impact on individuals with disabilities and the elderly, both of whom are more likely than the general applicant pool to receive substantial nontaxable income. The lender's policy is likely to be proven discriminatory. First, the lender is unlikely to be able to show that the policy is compelled by business necessity. Second, even if the lender could show business necessity, the lender could achieve the same purpose with less discriminatory effect by "grossing up" nontaxable income (i.e., making it equivalent to gross taxable income by using formulas related to the applicant's tax bracket)."

For real estate loans it's important to note that Appendix Q of Regulation Z (1026 – Appendix Q) supports the idea that certain income "may" be grossed up, if it is deemed that the income was not taxed. This income includes; social security, child support, homeownership subsidies or other income that is deemed to be untaxed. This practice can pose fair lending risk, when not applied uniformly.

Lenders should follow a consistent approach to grossing up income derived from sources that are not taxable, such as by using formulas related to the applicant's tax bracket or a certain bank established metric. A financial institution's loan policy and underwriting guidelines should also address the process for grossing up non-taxable income to promote consistency between loan officers and underwriters.



CFPB Proposes Changes to "Rural and Underserved" Definition

On January 29, 2015 the CFPB published proposed changes to the definitions of rural and underserved, with the goal of expanding access to lending from community banks. The proposal is designed to provide certain relief to financial institutions and expand the definitions of small creditors and creditors who primarily serve "rural and underserved" communities.

This change would increase the number of financial institutions that would have more flexibility for documenting a borrower's ability to repay and expand the number of institutions that can make small creditor balloon loans. The proposal extends to more than lenders who primarily serve rural and underserved communities. The CFPB proposal expands the criteria for "rural and underserved" communities by modifying the definition of "rural" to exempt communities not located in census blocks that are not located in urban areas as defined by the US Census Bureau. This means more communities will fall under the definition of "rural".

In addition to modifying the definition of rural, the CFPB proposes modifying the criteria for determining if an institution primarily serves "rural and underserved" communities by modifying the qualifying period from any one of the prior three years, to just the prior year.

The CFPB proposal also expands the definition of small creditor. Under the proposal, the loan origination limit for small-creditor status would be raised from 500 first-lien mortgage loans to 2,000 and would exclude loans held in portfolio by the creditor and its affiliates. The proposal would not change the current asset limit for small-creditor status, which is set at less than $2 billion (adjusted annually) in total assets as of the end of the preceding calendar year. However, the proposal would include the assets of the creditor's mortgage-originating affiliates in calculating whether a creditor is under the limit.

The bureau has proposed extending the allowance of balloon payment loans made by small creditors, for applications received before April 1, 2016. Small creditor balloon payment loans are set to expire January 10, 2016. Creditors that exceeded the origination limit or asset-size limit in the preceding calendar year would be allowed to operate, in certain circumstances, as a small creditor with respect to mortgage transactions with applications received prior to April 1 of the current calendar year. The proposal would create a similar grace period for creditors that no longer operated predominantly in rural or underserved areas during the preceding calendar year.

For more information on the CFPB proposal, please visit: http://www.consumerfinance.gov/newsroom/cfpb-issues-proposal-to-facilitate-access-to-credit-in-rural-and-underserved-areas/

Sunset of the Protecting Tenants in Foreclosure Act

As of December 31, 2014, the Protecting Tenants in Foreclosure Act has expired. The law, enacted as part of the Dodd-Frank Consumer Protection Act, was originally set to expire in December 2012, but Congress extended the term of the Act for two years.

Despite legislation proposed to make the Act permanent (H.R. 3543 and S. 1761), neither house of Congress acted and the Act expired. Any foreclosure protections provided to tenants are now dictated at the state level and institutions are encouraged to review their state's specific tenant laws, as many states have lesser protections afforded to tenants in foreclosure.

A financial institution should review its policy to determine the appropriate course of action and update its policy as necessary. Several national banking institutions have publically commented that they will voluntarily follow the guidelines set forth by the Act. Nothing prohibits financial institutions from continuing to provide the protections that were afforded in the Act. As a refresher, the Act allowed tenants to stay in a rented property until the end of the lease unless either (a) the lease is terminable at will or (b) the property was sold after foreclosure and the buyer intends to use the property as his or her primary residence. The immediate successor in interest of a dwelling or residential real property had to provide tenants with a notice to vacate at least 90 days before the effective date of such notice in any case.

A bill was introduced to the House of Representative (H.R. 1354) on March 13th 2015 to repeal the sunset date and make permanent the provisions of the Protecting Tenants at Foreclosure Act of 2009. The bill was referred to the House Committee on Financial Services and no further action has been taken.

TILA-RESPA Integrated Disclosure Rule: Top Five Things You Need to Know

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The following are the top five things that a Bank's management team should understand when preparing to implement the TILA-RESPA rule.

1. Expanded Coverage

The TILA-RESPA rule applies to most closed-end consumer credit transactions secured by real property, but does not apply to revolving home equity lines of credit (HELOCs), reverse mortgages, or chattel-dwelling loans, such as loans secured by a mobile home or by a dwelling that is not attached to real property. As such, certain types of loans exempted under current RESPA disclosure requirements will be subject to the TILA-RESPA rule's Integrated Disclosure requirements, including temporary loans, such as construction-only loans or bridge loans, loans secured by vacant land or by 25 or more acres, as well as credit extended to certain trusts for tax or estate planning purposes.

2. Delivery of disclosures – consumer receipt

In part, the Loan Estimate must be delivered or placed in the mail no later than the seventh business day (including Saturday) before consummation of the transaction. Creditors must also ensure that consumers receive the Closing Disclosure no later than three business days (including Saturday) before consummation. Creditors may contract with settlement agents to have the settlement agent provide the Closing Disclosure to consumers on the creditor's behalf. Creditors and settlement agents also may agree to divide responsibility with regard to completing the Closing Disclosure, with the settlement agent assuming responsibility to complete some or all of the Closing Disclosure. Any such creditor must maintain communication with the settlement agent to ensure that the Closing Disclosure and its delivery satisfy the requirements described above, and the creditor is legally responsible for any errors or defects.

If the Loan Estimate and/or Closing Disclosure are not provided to the consumer in person, the consumer is considered to have received the disclosure three business days (including Saturday) after it is delivered or placed in the mail. However, if the creditor has evidence that the consumer received the disclosure earlier than three business days (counting Saturday) after it is mailed or delivered, it may rely on that evidence and consider it to be received on that date.

3. Third Party Charges not required by the creditor

The current Good Faith Estimate required by RESPA only includes third party charges that the creditor is requiring in connection with the transaction. The new Loan Estimate must also include an itemization of any other amounts in connection with the transaction that the consumer is likely to pay or has contracted with a person other than the creditor or loan originator to pay at closing and of which the creditor is aware at the time of issuing the Loan Estimate. For example, if the Bank has a copy of a sales contract that identifies the borrower will pay for a home inspection at the time the Loan Estimate is prepared, the charges for the home inspection must be reflected in the disclosures.

4. Good Faith Standard

Similar to the standards provided for the Good Faith Estimate under RESPA, the figures stated on the Loan Estimate will be binding and subject to varying tolerance levels regarding increases to actual charges paid at consummation. While the tolerance levels are similar to the current standards identified in RESPA, some significant changes have been made under the new rules that create a new category of fees subject to zero tolerance.

Creditors are responsible for ensuring that the figures stated in the Loan Estimate are made in good faith and consistent with the best information reasonably available to the creditor at the time they are disclosed. The "reasonably available" standard requires that the creditor, acting in good faith, exercise due diligence in which the creditor may rely on the representations of other parties in obtaining the information. Whether or not a Loan Estimate was made in good faith is determined by calculating the difference between the estimated charges originally provided in the Loan Estimate and the actual charges paid by or imposed on the consumer in the Closing Disclosure. Generally, if the charge paid by or imposed on the consumer exceeds the amount originally disclosed on the Loan Estimate it is not in good faith, regardless of whether the creditor later discovers a technical error, miscalculation, or underestimation of a charge, with certain identified tolerance levels.

An important factor on how the tolerances will apply to creditor required third party charges will depend upon whether or not the creditor permits the consumer to shop for the settlement service provider or not.

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A creditor permits a consumer to shop for a settlement service if the creditor permits the consumer to select the provider of that service, subject to reasonable requirements. For example, the creditor may require that a settlement agent chosen by the consumer must be appropriately licensed in the relevant jurisdiction. In contrast, a creditor does not permit a consumer to shop for these purposes if it requires the consumer to choose a provider from a list provided by the creditor. In addition to the Loan Estimate, if the consumer is permitted to shop for a settlement service, the creditor must provide the consumer with a separate written list of services for which the consumer can shop, subject to specific formatting and content requirements.

Permitted Variations

For certain costs or terms, creditors are permitted to charge consumers more than the amount disclosed on the Loan Estimate without any tolerance limitation. However, creditors may only charge consumers more than the amount disclosed when the original estimated charge, or lack of an estimated charge for a particular service, was based on the best information reasonably available to the creditor at the time the disclosure was provided. These charges are:

- Prepaid interest; property insurance premiums; amounts placed into an escrow, impound, reserve or similar account
- For services required by the creditor if the creditor permits the consumer to shop and the consumer selects a third-party service provider not on the creditor's written list of service providers
- Charges paid to third-party service providers for services not required by the creditor (may be paid to affiliates of the creditor)

Limited Increases: 10% cumulative tolerance

Charges for third-party services and recording fees paid by or imposed on the consumer are grouped together and subject to a 10% cumulative tolerance. This means the creditor may charge the consumer more than the amount disclosed on the Loan Estimate for any of these charges so long as the total sum of the charges added together does not exceed the sum of all such charges disclosed on the Loan Estimate by more than 10%. These charges are:

- Recording fees
- Charges for third-party services where:
  - The charge is not paid to the creditor or the creditor's affiliate, and
  - The consumer is permitted by the creditor to shop for the third-party service, and the consumer selects a third-party service provider on the creditor's written list of service providers or elects not to choose a provider

Zero Tolerance Charges

For all other charges, creditors are not permitted to charge consumers more than the amount disclosed on the Loan Estimate under any circumstances other than changed circumstances (similar to the current RESPA standards for Good Faith Estimates) that permit a revised Loan Estimate be provided with three business days of learning of the reason for the revision. These zero tolerance charges are:

- Fees paid to the creditor, mortgage broker, or an affiliate of either
- Fees paid to an unaffiliated third party if the creditor did not permit the consumer to shop for a third party service provider for a settlement service, or
- Transfer taxes

If the amounts paid by the consumer at closing exceed the amounts disclosed on the Loan Estimate beyond the applicable tolerance threshold, the creditor must refund the excess to the consumer no later than 60 calendar days after consummation.

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5. Pre-disclosure Fee Restrictions

A creditor or other person may not impose any fee on a consumer in connection with the consumer's application for a mortgage transaction until the consumer has received the Loan Estimate and has indicated intent to proceed with the transaction. The only exception to this exclusion is for a bona fide and reasonable fee for obtaining a consumer's credit report.

A consumer indicates intent to proceed with the transaction when the consumer communicates, in any manner, that the consumer chooses to proceed after the Loan Estimate has been delivered, unless a particular manner of communication is required by the creditor. A consumer indicating an intent to proceed may include oral communication in person immediately upon delivery of the Loan Estimate, oral communication over the phone, written communication via email, or signing a pre- printed form after receipt of the Loan Estimate. However, a consumer's silence is not indicative of intent to proceed. Documentation of the borrower expressing intent to proceed after reviewing the Loan Estimate is subject to record retention requirements.

A fee is imposed by a person if the person requires a consumer to provide a method for payment, even if the payment is not made at that time. This would include, for example:

- A creditor or mortgage broker requiring the consumer to provide a check to pay for a processing fee before the consumer receives the Loan Estimate, even if the check is not to be cashed until after the Loan Estimate is received and the consumer has indicated an intent to proceed
- A creditor or mortgage broker requiring the consumer to provide a credit card number for a processing fee before the consumer receives the Loan Estimate, even if the credit card will not be charged until after the Loan Estimate is received and the consumer has indicated an intent to proceed

Flood Insurance and Contents Coverage Requirements

Flood insurance contents coverage typically becomes relevant on commercial credits when a bank accepts equipment, fixtures, and/or furnishings, in addition to the building as collateral. If a bank establishes a security interest in contents and a building in a special flood hazard area, flood insurance coverage is required for both the building and contents. To determine the minimum amount of required flood insurance coverage the "lesser of the three" test still applies.

The Joint Agencies Flood Insurance Q&A #39 explains how to apply the coverage. "Example: Lender A makes a loan for $200,000 that is secured by a warehouse with an insurable value of $150,000 and inventory in the warehouse worth $100,000. The Act and Regulation require that flood insurance coverage be obtained for the lesser of the outstanding principal balance of the loan or the maximum amount of flood insurance that is available under the NFIP. The maximum amount of insurance that is available for both building and contents is $500,000 for each category. In this situation, federal flood insurance requirements could be satisfied by placing $150,000 worth of flood insurance coverage on the warehouse, thus insuring it to its insurable value, and $50,000 worth of contents flood insurance coverage on the inventory, thus providing total coverage in the amount of the outstanding principal balance of the loan. Note that this holds true even though the inventory is worth $200,000."

As illustrated in the example above, the bank needs coverage for the loan amount of $200,000 which is the lesser of the loan amount, insurable value and maximum amount of insurance available. There is no special formula for allocating an amount for contents coverage and an amount for building coverage. The bank is simply required to obtain some coverage on each. So theoretically, the bank could have allocated $195,000 to the building and $5,000 to contents coverage. However, it is also important to have a good understanding of the insurable value of the contents. The bank would not want to over-insure the contents to a level the insurer would not pay out the full amount of the policy. In this example, the institution would not need to exceed $100,000 for contents coverage as that is the value of the inventory.

If a bank secures a loan with only contents in a flood zone, not the building and contents, the regulation does not require flood insurance. However, from a practical risk standpoint flood insurance on the contents would be advisable. If your bank commonly places UCC-1s, notes fixtures in the security section or otherwise obtains a security interest in equipment, fixtures, or furnishings be sure to obtain flood insurance contents coverage when necessary.

Overdraft Concerns and CFPB Enforcement

Overdraft programs and processes have been under increased regulatory scrutiny. Recently the CFPB has made news with its first enforcement penalty for overdraft practices. The CFPB recently levied a $7.5 million penalty against Regions Bank for what it termed "illegal actions", even after Regions Bank refunded $49 million in overdraft fees to its customers. Per the CFPB's press release, in instances where consumers had checking accounts which were linked to savings accounts or lines of credit for overdraft purposes, and ATM or one time debit card transactions exceeded the available balance in both the checking account and the linked account, the bank's standard overdraft fee was charged. The issue was that the bank didn't obtain an opt-in for these customers, thus charging a fee would be prohibited. The bank needed to obtain the consumer's consent to charge for such transactions via the opt-in process. The take away from this enforcement action is to ensure that your bank does not have a similar process. If an institution's pay, return, and charge decisions are completed at an account officer level, all responsible individuals must understand that without an opt-in, the customer cannot be charged an overdraft fee for ATM or one time debit card transactions.

The CFPB also raised another overdraft related concern in their Supervisory Insights Winter 2015 edition. The CFPB noted that several banks "switched from a ledger-balance method to an available-balance method for purposes of deciding whether to authorize signature based debit transactions and other electronic transactions (collectively "electronic transactions") and whether to post or return checks and ACH transactions. In addition, one or more institutions switched to an available-balance method for purposes of calculating whether a transaction results in an overdraft, and/or whether an overdraft fee is assessed when a transaction is settled."

The ledger balance method includes only settled transactions in calculating an account's balance; an available-balance method calculates an account's balance based on electronic transactions that the bank has authorized but not yet settled, along with settled transactions. An available balance also typically reflects holds on deposits that have not yet cleared (e.g. Regulation CC hold, merchant holds, etc.). The CFPB noted that in some cases an overdraft fee was charged for an available balance deficiency where the fee would not have been charged as a ledger balance deficiency. The CFPB further found that these practices, along with a failure to notify the consumer of the changes to the available balance method, caused consumer harm and were considered unfair. No regulation requires the disclosure of the balance on which overdrafts will be charged, however, this is a potential UDAAP concern.

Return and charge decisions should be made on a consistent basis if these decisions are completed manually at an account officer or branch level. It is recommended that a financial institution consider disclosing the balance computation method on which overdraft fees will be charged to customers to ensure clarity.

Read the full article at the link: http://files.consumerfinance.gov/f/201503_cfpb_supervisory-highlights-winter-2015.pdf .

Email us at compliancenewsletter@shpco.net with any questions or comments.

Visit our website at www.shpco.net to register your email for the Compliance Pipeline!