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Regulatory Compliance Webinar Series:
Your compliance Q&A and the Bank Secrecy Act

November 14, 2013

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McGladrey Presenters

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Agenda

- **Approach to and issues with the new mortgage servicing rules**
- **Compliance Q&A**:
  - **Compliance management systems**: We'll discuss the regulators' renewed interest in your CMS.
  - **New mortgage rules**: We'll relay answers to questions we've received regarding the new CFPB-issued mortgage rules.
  - **Third-party vendor management**: We'll provide insight to this area of high regulatory concern.
- **Bank Secrecy Act**: We'll highlight how to mitigate the risks posed by customers and new products that technology is rushing in at an increasing pace.
- **Updates and reminders**

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Approach to and Issues with the New Mortgage Servicing Rules

Mortgage Servicing Rules

- Introduction of CFPB rules impacting residential loan servicers
- McGladrey's experience dealing with the new servicing regulations

POLLING QUESTION #1

Mortgage Servicing Rules (cont.)

- New rules can be put into various buckets:
  - Timeliness
  - Accuracy
  - Force-placed insurance
  - Error resolution and information requests
  - Loss mitigation

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Mortgage Servicing Rules (cont.)

- Timeliness:
  - Assigning a single point of contact (SPOC)
  - Responding to receipt of missing loan modification documents
  - Informing borrower of loan modification denial decision
  - Responding to borrower appeals
  - Giving borrower time to accept or decline loan modification before initiating foreclosure
  - Giving borrower time to comply with trial period before initiating foreclosure
  - Approval of short sale requests
  - Payment applications
  - Interest rate adjustments
  - Payoff balance requests

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Mortgage Servicing Rules (cont.)

Accuracy:

- Period billing statements
- Reasons loss mitigation did not occur

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Mortgage Servicing Rules (cont.)

- Potential Issues:
  - Meeting respective timeline requirements
  - Over charging borrower for fees and other expenses
  - Complying with force-placed insurance requirements
  - Improper communication regarding SPOC's
  - Improper denial of loan modification requirements
  - Improper communication regarding short sales
  - Not having legal standing to foreclose
  - Dual tracking borrowers

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Mortgage Servicing Rules (cont.)

- Challenges, new rules require:
  - New Policies and Procedures
  - System changes
  - Training
  - Development and delivery of a compliance program
- Initial findings of the CFPB

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Mortgage Servicing Rules Best Practice Database

- Developed internal control framework/database for the CFPB mortgage servicing rules which covers:
  - The nine major areas of the rules
  - Control objectives
  - Best practice internal controls
  - Suggested test plans
- Jump-starts compliance efforts, rather than starting from scratch
- Serves as the documentation and testing repository
- Easy to use and roll-out to the organization

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Compliance Q&A

Compliance Management System

- Compliance management system
  - Enterprise-wide risk management specific to compliance
  - Product and service lifecycle
  - Integrated into management's day-to-day activities
- Common elements of a CMS
  - Board and management oversight
  - Compliance program
  - Response to consumer complaints; and
  - Compliance audit

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POLLING QUESTION #2

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Compliance Management System (cont.)

- Compliance program
  - The business plan of the CMS
  - Policies and procedures
  - Training; and
  - Monitoring and corrective action
- Key factors for an effective CMS
  - An engaged board and senior management team
  - Compliance must be a culture, not a cost
  - A sufficient populace of compliance resources
  - Consumer protection focused

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New CFPB Rules Q&As

- Ability-to-Repay Rule
  - Points and Fees
  - Verification – tax returns
  - Terming out HELOCs
- Loan Originator Rules
  - Compensation
  - NMLSR Number

Materials:

- Recordings and slides of CFPB webinar: http://mortgagebankers.org/Compliance/cfpbrecordings.htm
- Points and fees and finance charge Definitions
- CFPB's basic guide for lenders on what is a qualified mortgage

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Points and Fees

§1026.32(b)(1): For closed-end credit transactions, points and fees means the following fees or charges that are known at or before consummation (open-end discussed separately):

(i) Items included in the finance charge under § 1026.4(a) and (b) (unless excluded)

(ii) Loan originator compensation paid directly or indirectly by a consumer or creditor

<u>(iii) Items listed in § 1026.4(c)(7) (unless excluded)</u>

(iv) Certain charges or premiums for credit insurance and other products

(v) Maximum prepayment penalty that may be charged under the transaction terms

(vi) Total prepayment penalty incurred by the consumer

cfpb Consumer Financial Protection Bureau

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Points and Fees (cont.)

1026.32(b)(1):

(1) In connection with a closed-end credit transaction, points and fees means the following fees or charges that are known at or before consummation:

(iii) All items listed in § 1026.4(c)(7) (other than amounts held for future payment of taxes), **unless:**

- (A) The charge is reasonable;
- (B) The creditor receives no direct or indirect compensation in connection with the charge; and
- (C) The charge is not paid to an affiliate of the creditor

Points and Fees (cont.)

- Affiliate: Section 1026.32(b)(5): *Affiliate means any company that controls, is controlled by, or is under common control with another company, as set forth in the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.).*
- **Bank Holding Company Act of 1956** (12 U.S.C. 1841, *et seq.) provides in part that a company has control over a bank or over any company if:*
  - (A) the company directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company;
  - (B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or
  - (C) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.

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Points and Fees (cont.)

1026.4(c)(7):

(7) *Real-estate related fees.* The following fees in a transaction secured by real property or in a residential mortgage transaction, if the fees are bona fide and reasonable in amount:

(iii) Notary and credit-report fees.

(iv) Property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest-infestation or flood-hazard determinations.

(v) Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge. (this includes **<u>Property insurance)</u>**

CFPB Interpretation: The CFPB states that only the amount retained by the affiliate has to be counted towards points and fees ("paid to" meaning the person that is the ultimate recipient).

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Points and Fees - HELOCs

- The points and fees calculation for HELOCs to determine HOEPA coverage is the same as closed-end credit with the addition of two charges that must be included:

1. (vii) Any fees charged for participation in an open-end credit plan, payable at or before account opening, as described in § 1026.4(c)(4); and
2. (viii) Any transaction fee, including any minimum fee or per-transaction fee, that will be charged for a draw on the credit line, where the creditor must assume that the consumer will make at least one draw during the term of the plan.

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Verification of Income – Tax Returns

1026.43(c)(4):

(4) *Verification of income or assets.* A creditor must verify the amounts of income or assets that the creditor relies on under § 1026.43(c)(2)(i) to determine a consumer's ability to repay a covered transaction using <u>third-party records that provide reasonably reliable evidence of the consumer's income or assets.</u> A creditor may verify the consumer's income using a tax- return transcript issued by the Internal Revenue Service (IRS). Examples of other records the creditor may use to verify the consumer's income or assets include:

(i) Copies of tax returns the consumer <u>filed with the IRS</u> or a State taxing authority;

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Verification of Income – Tax Returns (cont.)

- The financial institution should not accept as verification of income, an applicant's signed, self-prepared tax return, unless income values are further verified through a third party.

  Income values must be verified through a third party. If the financial institution has a third party item such as paystubs or an accountant or other third party tax preparer that has prepared the tax returns (other than the borrower), then the income values are considered reasonably reliable.

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Verification of Income – Tax Returns (cont.)

- If a borrower presents a signed tax return must the institution also <u>verify that it was filed with the taxing authority</u> or may we assume that since it was signed, it was also filed?

  If the tax return was prepared or reviewed by a third party that was an agent of the consumer (not an agent of the creditor or broker) then it would be considered reasonably reliable source and the financial institution would not have to get proof it was filed by the IRS. If it is the institution's procedures are to get a transcript from the IRS – great, but you wouldn't need to in order to rely on the tax return for the income amount. If the tax return was self-prepared (no third party review and absent any other third party document that would be reasonably reliable such as a paystub) then the tax return would have to be verified that it was filed with the IRS.

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HELOCs Without a Repayment Phase

- For customers with Home Equity Lines of Credit that are maturing with a balloon balance due (no repayment phase and draws are permitted until maturity at which time the balance becomes due) – putting them into a home equity term loan will require determining the borrower's ATR even if it is considered a workout.

  The ATR doesn't mean you have to meet the QM guidelines, you only need to show a good faith determination. Even if it is a workout, it would be considered a new transaction requiring the application of the ATR. If having a hard time selling the loans on the secondary market, you will have to hold them in portfolio.

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POLLING QUESTION #3

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Loan Originator Compensation

- Managers are considered loan originators if they take an application, offer, arrange, assist a consumer with obtaining or applying to obtain, negotiate, or otherwise obtain or make a particular extension of credit for another person. They are referred to as producing managers.

Loan Originator Compensation: General

- If you are a loan originator, you generally may not receive compensation (bonus included) that is based on the terms of multiple transactions conducted by multiple individual loan originators.
- You can structure retirement and bonus plans that are based on mortgage-related profits in ways that do not violate the rule's ban on compensation based on terms of multiple transactions conducted by multiple individual loan originators. The rule includes provisions on designated tax-advantaged (deferred) plans and non-deferred profits-based compensation plans.

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Loan Originator Compensation: Tax-Advantaged Plans (deferred)

- You may structure tax-advantaged <u>deferred</u> compensation that is based on mortgage-related profits in two ways:

  1. A contribution to a defined contribution plan that is a designated tax-advantaged plan.

  2. A benefit under a defined benefit plan that is a designated tax-advantaged plan.

- If you are an employer and make a contribution to a defined contribution plan for an individual loan originator, you may **not** base the contribution on the terms of that originator’s transactions.

Note: Some deferred compensation plans are not designated tax-advantaged plans. Payments, contributions, or benefits under those deferred compensation plans may not be based on mortgage-related business profits.

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Loan Originator Compensation: Non-Deferred

(iv) An individual loan originator may receive, and a person may pay to an individual loan originator, compensation under a non-deferred profits-based compensation plan (i.e., any arrangement for the payment of non-deferred compensation that is determined with reference to the profits of the person from mortgage-related business), provided that:

(A) The compensation paid to an individual loan originator pursuant to this paragraph (d)(1)(iv) is not directly or indirectly based on the terms of that individual loan originator's transactions that are subject to this paragraph (d); and

(B) At least one of the following conditions is satisfied:

(*1*) The compensation paid to an individual loan originator pursuant to this paragraph (d)(1)(iv) does not, in the aggregate, exceed 10 percent of the individual loan originator's total compensation corresponding to the time period for which the compensation under the non-deferred profits-based compensation plan is paid; or

(*2*) The individual loan originator was a loan originator for ten or fewer transactions subject to this paragraph (d) consummated during the 12-month period preceding the date of the compensation determination.

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NMLSR Number on Loan Documents

1026.36(g)(1)(ii) - Commentary

1. *Multiple individual loan originators.* If more than one individual meets the definition of a loan originator for a transaction, the name and NMLSR ID of the individual loan originator with primary responsibility for the transaction at the time the loan document is issued must be included. A loan originator organization that establishes and follows a reasonable, written policy for determining which individual loan originator has primary responsibility for the transaction at the time the document is issued complies with the requirement. If the individual loan originator with primary responsibility for a transaction at the time a document is issued is not the same individual loan originator who had primary responsibility for the transaction at the time that a previously issued document was issued, the previously issued document is not required to be reissued merely to change a loan originator name and NMLSR ID.

You have to use a name that is searchable within the NMLSR database so you can use the formal name that was used for registration or any alias that was put into NMLSR database on your note, application and security agreement forms.

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Third Party Vendor Relationships

- Vendor relationships are tied to key operational strategies, such as:
  - Access to specific and dedicated expertise
  - Cost containment and reduction
  - Operational efficiencies
- Examples of vendor relationships
  - Technology service providers such as software vendors
  - Loan documentation platform vendors
  - Loan servicing vendors such as companies that provide foreclosure assistance, insurance monitoring, recoveries and debt collections

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Third Party Vendor Management

- View your vendor's compliance management program as an extension of your own
- Risk-based due diligence activities
  - High level Compliance Management System review
  - Compliance policies and procedures
  - Risk assessment
  - Formalized consumer complaint process
  - Monitoring/compliance reviews
  - Corrective action measures
  - Employee training
- Work with vendors that can demonstrate a regulatory compliance culture

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POLLING QUESTION #4

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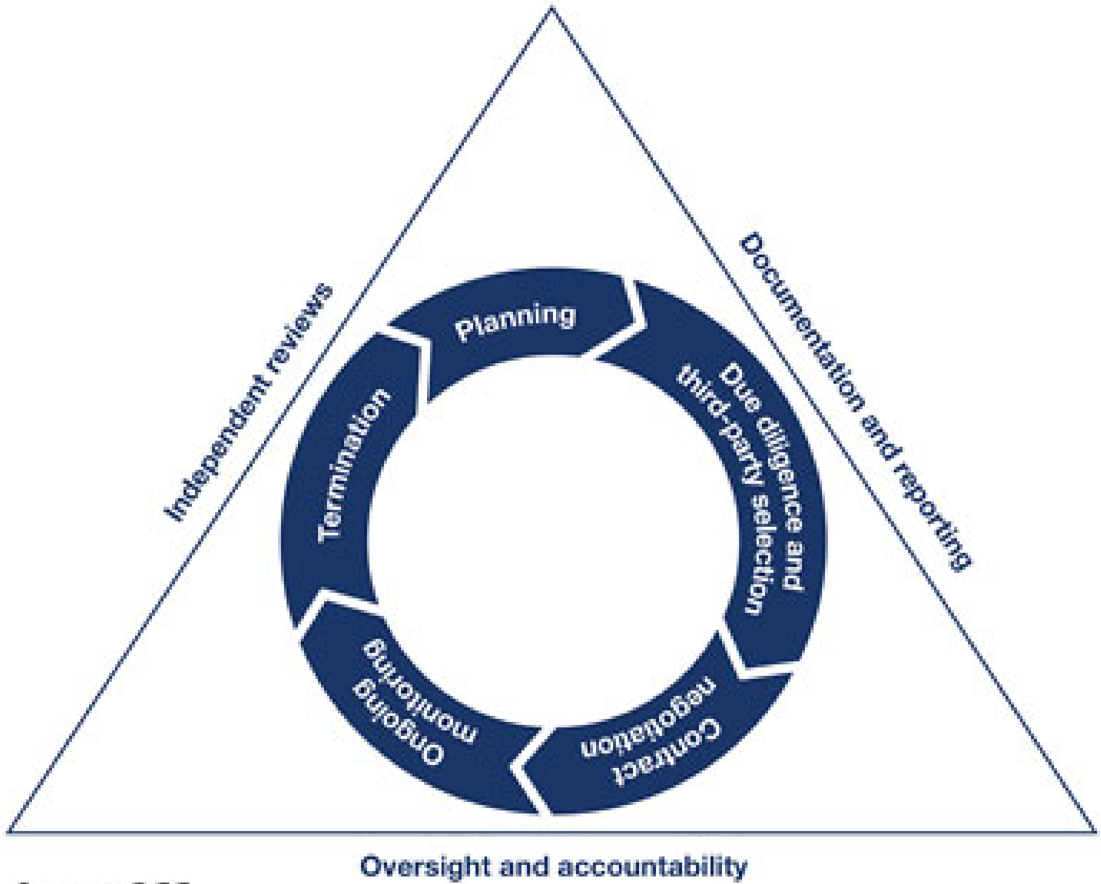
Risk Management Life Cycle (Third Party Relationships)



Source: OCC

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Bank Secrecy Act

BSA - Agenda

- Overview
- Third party payment processors
- Prepaid cards
- Payroll cards
- Remote Deposit Capture
- Privately Owned ATMs
- Industry Updates

BSA Overview

- Emerging technology creates faster and easier access to funds
  - Availability through mobile and online banking, prepaid cards, payroll cards, smart ATM machines, mobile wallets, and cloud-based payment processes
  - Increases associated risks and the need for mitigating controls
- Higher-risk customers that use technology to provide services
  - Third party payment processors, remote capture customers, private ATM owners.
  - Heightened awareness for customer identification and due diligence

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Third Party Payment Processors

- Definition
  - The institution’s customers that provide payment-processing services to merchants and other business entities.
- Risks
  - With the expansion of the Internet, the need for physical locations has decreased. Processors now provide services to conventional retail and Internet-based establishments, prepaid travel, telemarketers, and Internet gaming enterprises.
  - Use of commercial bank accounts to conduct payment processing for their merchant clients and often do not have an effective means of verifying their merchant clients’ identities and business practices .
  - The bank does not have a direct relationship with the merchant.

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Third Party Payment Processors (cont.)

- Controls
  - CIP/CDD - adequate due diligence on the merchants
  - Identify and understand the nature and source of the transactions processed through an account
  - Monitor the processor relationships for any significant changes in the processor's business strategies that may affect the overall risk profile.
  - Know your customer's customers

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Prepaid / Stored Value Cards

- Definition
  - Monetary value is physically stored on the card, linked to funds held in a pooled account, operate within either an “open” or “closed” system.
  - Open system include payroll cards and gift cards that can be used anywhere a credit card can be used – they are reloadable. Closed system includes merchant-specific retail gift cards, mall cards, and mass transit system cards.
- Risks
  - Anonymity of the cardholder, fictitious cardholder information, cash access of the card, and the volume of funds that can be transacted on the card.
  - Funding initial deposits with stolen credit cards or purchased multiple cards under aliases.
  - Load cash from illicit sources onto prepaid cards
  - Open and closed system prepaid cards have been used in bulk cash smuggling

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Prepaid / Stored Value Cards (cont.)

- Controls
  - Customer due diligence - identify and verify cardholder identity.
  - Know the type, purpose, and anticipated activity of the prepaid card program.
  - Limits or prohibitions on cash loads, access, or redemption.
  - Controls on the number of cards purchased by one individual.
  - Limits on aggregate card values.

Payroll Cards

- Definition
  - Employers offer prepaid payroll cards as an option for making payroll payments to employees.
- Risks
  - Anonymity of the cardholder, lack of CIP
  - Numerous recipients of funds from employer’s account
- Controls
  - Customer due diligence - identify and verify entity issuing payroll cards
  - Risk assessment of all third parties involved
  - Monitor the transaction activity, ensure volume and transactions are within expectations
  - Establish maximum load amounts and spending limits

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POLLING QUESTION #5

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Remote Deposit Capture

- Definition
  - Deposit transaction delivery system allows the customer to scan a check or monetary instrument, and then transmit the scanned or digitized image to the institution.
    - Physical equipment to businesses for scanning bulk checks for deposit
    - Consumers use mobile device to take photographs of check item for deposit
- Risks
  - Information security risks – address institutions IT environment as well as RDC user's controls
  - Channel for fraudulent, altered check items
  - Lack of inspection of items and source of funds by the institution
  - Accepting foreign transactions, anonymity of source of funds

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Remote Deposit Capture (cont.)

- Controls
  - Incorporate into institution’s risk assessment
  - Establish guidelines to qualify customers for this service
  - Conduct risk assessment and due diligence
  - Ongoing due diligence, adequate management board reporting

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Privately Owned ATMs

- Definition
  - Owned by the proprietors of the establishments in which they are located.
  - An ISO often acts as an agent for merchants, including ATM owners, to process electronic transactions. In some cases, an ATM owner may act as its own ISO processor. ISOs link their ATMs to an ATM transaction network.
- Risks
  - ISO accounts can be located at a bank anywhere in the world.
  - Most states do not currently register, limit ownership, monitor, or examine privately owned ATMs or the ISOs.
  - ATM may be replenished with illicit currency that is subsequently withdrawn by legitimate customers.

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Privately Owned ATMs (cont.)

- Controls
  - Conduct proper due diligence on the ISO, maintain adequate documentation to ensure the ISO complies with all network rules.
  - Understand the controls for delivery arrangements for privately owned ATMs, including source of replenishment currency.
  - Monitoring of account, know the expected account activity, including currency withdrawals.

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News & Updates

- FinCEN Signs MOU with Mexico to Strengthen Fight against Money Laundering/Terrorist Financing
  - Particularly in the area of money services businesses
  - MOU provides for strict controls and safeguards to ensure that shared information
  - http://www.fincen.gov/news_room/nr/pdf/20131024.pdf
- FinCEN Encourages Voluntary Information Sharing
  - FinCEN issues fact sheet
  - http://www.fincen.gov/statutes_regs/patriot/pdf/314bfactsheet.pdf

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Updates and Reminders

Reminders

- A reminder from the CFPB about the importance of HMDA data accuracy and an effective HMDA compliance management system: http://files.consumerfinance.gov/f/201310_cfpb_hmda_compliance-bulletin_fair-lending.pdf.
- Regulation E Remittance Transfer Rule effective on October 28th. Three actions taken by the CFPB:
  1. Consumer education campaign: http://www.consumerfinance.gov/newsroom/cfpb-launches-education-campaign-about-new-international-money-transfer-protections;
  2. eRegulations – online tool: http://www.consumerfinance.gov/newsroom/cfpb-procedures-to-ensure-consumers-making-remittance-transfers-are-protected/
  3. Published examination procedures: http://files.consumerfinance.gov/f/201310_cfpb_remittance-transfer-examination-procedures.pdf

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POLLING QUESTION #6

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Updates

New Rules, Final and Proposed:

- Telemarketing rules: http://www.fcc.gov/document/fcc-strengthens-consumer-protections-against-telemarketing-robocalls
- Interagency proposal to implement flood insurance rules: http://www.fdic.gov/news/board/2013/2013-10-08_notice_dis_a_fr.pdf

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Updates

New Rules, Final and Proposed (cont.):

- CFPB Interim final rule and bulletin on homeownership counseling and servicing issues: http://files.consumerfinance.gov/f/201310_cfpb_mortgage-servicing_interim.pdf and http://files.consumerfinance.gov/f/201310_cfpb_mortgage-servicing_bulletin.pdf
- CFPB rule to describe homeownership counseling data instructions: http://files.consumerfinance.gov/f/201311_cfpb_interpretive-rule_homeownership-counseling-organizations-lists.pdf
- CFPB's tool to help consumer's find housing counselors: http://www.consumerfinance.gov/find-a-housing-counselor/

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Updates

New Rules: Final and Proposed (cont.):

- HUD proposes QM guidelines for FHA mortgages: http://www.regulations.gov/#!documentDetail;D=HUD_FRDOC_0001-3490

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Updates

Interagency Statements:

- Fair lending and the ability to repay and qualified mortgage standards: http://www.fdic.gov/news/news/press/2013/pr13091a.html
- Standards for assessing diversity policies and practices: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131023a1.pdf

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Updates

CFPB complaints database:

- Payday lending: http://www.consumerfinance.gov/newsroom/cfpb-begins-accepting-payday-loan-complaints/
- Debt collectors: http://www.consumerfinance.gov/newsroom/cfpb-considers-debt-collection-rules/

Updates

Updates to manuals, guides and handbooks:

- FEMA revises NFIP Flood Insurance Manual and launched a website that explains the changes using different interactive tools: http://www.h2opartnersusa.com/manual-changes/index.html
- Small Entity Compliance Guide to the Ability-to-Repay/Qualified Mortgage Rule: http://files.consumerfinance.gov/f/201310_cfpb_atr-qm-small-entity_compliance-guide.pdf

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Updates

Updates to manuals, guides and handbooks (cont.):

- OCC updated the Comptroller's Handbook, replacing a 2006 booklet on insider activities: http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/_pdf/m-ia.pdf
- CFPB Guides for Caregivers and Fiduciaries: http://www.consumerfinance.gov/blog/managing-someone-elses-money/

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Thank you for joining us today!

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