COMMUNITY BANKERS ASSOCIATION OF OKLAHOMA

One Mission. Community Banks.®

CBAO 2015 WEEKLY COMPLIANCE UPDATES

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CBAO 2015 Weekly Compliance Updates
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A new year means new products, services, and activities for many community banks. If an activity is such that a national bank can engage in the activity, a state bank may be able to start that activity sooner than expected without advance FDIC approval. As a reminder, recent guidance from the FDIC provides a list of specific documentation requirements for such activities that, if maintained by a state bank, allows the bank to engage in such activities without advance approval from the FDIC. Such documentation includes:

1) A legal opinion from the bank's counsel;

2) A copy of a relevant statute or OCC regulation;

3) A copy of a relevant OCC official circular, bulletin, order, or interpretive letter; or

4) Other written documentation satisfactory to the FDIC.

If your new product and service policies and procedures haven't been reviewed in a while, it would be a good idea to review them to ensure they are consistent with this new guidance. Be aware that additional requirements apply if the activity is to be conducted by an unincorporated subsidiary of the state bank.

January 21, 2015

While many banks understand their healthcare clients' need to comply with the Health Insurance Portability and Accountability Act (HIPAA), not all are aware of the possibility of their own compliance obligations under the same law. With the passage of the Health Information Technology for Economic and Clinical Health Act (HITECH), those entities acting as "business associates" (providing services involving PHI) for healthcare providers became directly liable under HIPAA for protected health information (PHI) privacy and security. In providing lockbox services to a hospital, for example, a bank may fall into the category of "business associate" for the hospital, and become subject to the HIPAA Privacy and Security Rules. More recently, HIPAA regulations extended the obligations of business associates to their subcontractors – as an example, if the bank above uses a third-party shredding company to destroy documents containing PHI, then the bank's liability under HIPAA may extend to that shredding company.

For those banks covered by HIPAA as business associates, particular compliance requirements include developing and implementing HIPAA policies and procedures and performing a Security Rule risk assessment. In addition, banks utilizing sub-contractors may need to execute particular business associate agreements with those subcontractors, to address the subcontractors' responsibilities for HIPAA compliance, which are typically different than those between the bank and the healthcare provider.

If you have not considered any compliance obligations under HIPAA or HI-TECH that may be applicable to your products and services, or to any subcontractors that assist you in providing those products and services, it would be a good idea to do so. The HHS-OCR has announced that audits of business associates for compliance with specific HIPAA requirements will begin this year, with at least one banking agency already examining banks for HIPAA compliance.

February 4, 2015

The FDIC recently issued guidance for banks that originate private student loans with graduated payment terms. From FIL-6-2015, this guidance stresses that banks should underwrite such loans "in a manner consistent with safe and sound lending practices" and provide disclosures "that clearly communicate the timing and amount of payments" so that borrowers can fully understand their obligations.

To assist banks in doing so, the FDIC provided the following specific principles to be addressed in banks' policies and procedures for underwriting such loans:

1) Encouragement of orderly repayment through defined repayment terms, with rates consistent with current standards and without negative amortization or balloon payments;

2) Avoidance of payment shock through early, gradual increases in monthly payments;

3) Proper assessment of the borrower's "ability to repay the highest amortizing payment over the term of the loan," with payments "not…structured in a way that could mask delinquencies or defer losses;"

4) Promotion of full understanding by the borrower of the obligations under the loan, through clear, compliant disclosures;

5) Appropriate borrower protection through compliance with all appropriate and applicable consumer protection laws; and

6) Assistance to borrowers in establishing the appropriate priority and budget for student debt through contacting borrowers before a) the repayment period begins and b) each reset date.

February 18, 2015

Last week, the OCC issued a new booklet, "Deposit-Related Consumer Credit" (the "DRCC Booklet"), as part of the Comptroller's Handbook. The DRCC Booklet outlines the various risks of DRCC products (including overdraft line-of-credit and overdraft protection programs) and sets out a number of specific supervisory principles that OCC-supervised banks should apply to such products, including but not limited to the following:

1) Clear and conspicuous disclosures prior to enrollment, including clear indication that the product in question is a loan and information on alternative products less costly to the customer;

2) Customer enrollment by affirmative request only (after receipt of the disclosures in 1) above); and

3) Policies and procedures establishing a) eligibility and underwriting criteria, including determination of an applicant's financial capacity, b) appropriate limits on extensions of credit, and c) fees reasonably related to the costs and risks of the DRCC products offered.

In addition, the OCC sets out requirements for a) board and management involvement in the development and maintenance of such products, b) treatment of capital with respect to such products, and c) risk management and control systems applicable to DRCC products. Corresponding examination procedures, including an internal control questionnaire and sample examination request letter, are also included.

March 11, 2015

As a follow-up to the update from 2/18, on 3/6 the OCC replaced the previously-removed "Deposit-Related Consumer Credit" booklet (the "DRCC Booklet"), issued as part of the Comptroller's Handbook, with the "Deposit-Related Credit" booklet (the "DRC" Booklet). In the accompanying bulletin, the OCC indicated that the DRC Booklet "is intended as a summary restatement of existing laws, regulations, and policies applicable to deposit-related credit products and services," and that "[n]othing in this booklet should be interpreted as changing existing OCC policy."

March 25, 2015

If you haven't established a clear and definite process for addressing customer complaints, or have not revisited your current process lately, now may be the time to do so. Per a recently-announced policy, the CFPB will begin to allow customers of financial institutions to opt-in to making their complaint narratives public. Companies need not respond publicly, or may choose from a "set list of structured company response options." While banks below the CFPB's asset threshold may not be subject to regular CFPB supervision, complaints about such banks have been filed through this system.

Having a timely and suitable complaint management process often gives customers confidence that the bank will listen to their complaints and respond appropriately. Such a system may include the following elements:

1) A designated individual or individuals to manage the process – either coordinating with the business lines to ensure timely and appropriate responses, or responding directly if needed;

2) A written, easy-to-follow policy – in the event a complaint comes in via any employee, that employee should know what to do (even if his or her response is simply to refer the complaint to an appropriate party); and

3) Standardized tracking and recordkeeping – not only to track incoming complaints (and outgoing responses to them), but also to identify trends in complaints that may require larger-scale responses or changes to processes.

A proper complaint management system can also function as a type of radar, highlighting both a) areas of confusion for customers before that confusion arises to the level of a formal complaint and b) products, services, or processes that may need attention in advance of the next audit or regulatory examination.

<u>April 8, 2015</u>

While banks are not typically subject to rulemaking by the Financial Industry Regulatory Authority (the self-regulatory organization for broker-dealers), recent guidance may impact banks partnered with third-party broker-dealers in networking arrangements. In Regulatory Notice 15-07 released last month, FINRA announced approval by the Securities and Exchange Commission (SEC) of FINRA's Rule 2040, which prohibits various forms of compensation from being paid to unregistered persons or entities and, depending on the structure of the networking arrangement, could impact a bank's revenue flow from that arrangement.

Banks have been required for years to comply with Regulation R, which includes the following requirements for and restrictions on bank networking relationships with broker-dealers:

1) Nominal referral fees paid to unregistered bank employees for most referrals;

2) Higher referral fees permissible for "institutional" and "high net worth" customers (as defined by Reg R); and

3) No investment recommendations or advice provided by unregistered bank employees.

New Rule 2040, which incorporates requirements from prior NASD and NYSE rules, "prohibits [FINRA] member firms and associated persons from, directly or indirectly, paying any compensation, fees, concessions, discounts, commissions or other allowances" to any party that would be required by the SEC to be registered as a broker-dealer in order to receive such compensation. The Rule also includes the following guidance as to how FINRA member firms can make the determination as to whether or not registration may be required for the party to receive the payments in question, in that such firms may:

1) "Reasonably rely" on prior guidance from the SEC;

2) Seek a no-action letter from the SEC; or

3) Obtain opinion of "independent, reputable" counsel.

This recent rulemaking and guidance suggest that FINRA and the SEC will be paying attention to this issue, particularly as the Rule becomes effective on August 24, 2015. As such, bank personnel may receive questions from their partner broker-dealers as that compliance date approaches – to prepare for such questions, a review of current bank policies, procedures and practices around the networking arrangement would be recommended. In addition, specific policies, procedures, and practices relating to the bank's compliance with Reg R should be reviewed in the event bank regulators raise questions as well.

April 22, 2015

As discussed in an earlier CBAO Compliance Update, the TILA/RESPA integrated disclosure (TRID) rule is set to become effective on August 1 of this year. To that end, on April 1, 2015, the Consumer Financial Protection Bureau released revised TILA and RESPA examination procedures incorporating the new TRID requirements.

That compliance update also provided some specific topics for training and policy/procedure adjustment, including documentation of the submission of an application and simultaneous processing of applications with the “old” disclosures (for applications received before 8/1/15) and “new” disclosures (for applications received on or after 8/1/15). Recent actions from the CFPB, however, have highlighted some additional training and policy/procedure changes to incorporate into any planned review of mortgage processes in advance of the TRID effective date:

1) Mortgage servicing. On 4/21/15, the CFPB announced joint action with the Federal Trade Commission taken against Green Tree Servicing, LLC for various violations of the Federal Trade Commission Act, the Consumer Financial Protection Act, the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, and the Real Estate Settlement Procedures Act, which resulted in an agreement by Green Tree to pay $48 million in borrower restitution and a $15 million fine and implement various corrective actions. The complaint filed by the FTC and the CFPB lists several issues those agencies identified with the servicing process which banks may want to compare to their own practices.

2) Homeownership counseling. The CFPB issued on 4/15/15 a final interpretive rule regarding the provision of local homeownership counseling information to mortgage applicants, including guidance on using the tool found on the CFPB’s website and on combining the counseling information with other disclosures (such as those required by Reg X and Reg Z) which may be useful to integrate into current origination procedures.

3) Mortgage advertising. Action taken by the CFPB against RMK Financial for deceptive mortgage advertising was announced by the Bureau on 4/1/15. In the consent order on the CFPB’s website, in which RMK was required to pay a $250,000 civil penalty and implement various corrective actions, the CFPB outlined issues it identified with respect to RMK’s marketing of its services, including representation of endorsement or sponsorship by the Department of Veterans Affairs or the Federal Housing Administration and misrepresentations of loan interest rates and monthly payments.

As the compliance date for the new TRID requirements approaches and banks review their mortgage processes to identify any changes needed to comply with those new requirements, some review for issues highlighted by the CFPB in these recent actions may be warranted as well – given the amount of penalties and corrective action involved, it may be worthwhile to simply confirm that these issues aren’t present in current practices.

May 6, 2015

If your overdraft process is not in the “review regularly” column, recent action from the Consumer Financial Protection Bureau provides a number of reasons to move it there. The CFPB recently took action against improper overdraft fees on multiple fronts, most directly by levying significant penalties against Regions Bank for charging overdraft fees to customers who had not affirmatively opted-in as required by Regulation E’s Opt-In Rule. For example, Regions charged fees for overdrafts, without obtaining affirmative opt-in, in checking accounts linked to other accounts (if the checking account became overdrawn and there were insufficient funds in the linked account to cover the overdraw). While the issues had been previously identified by Regions, the consent order issued by the CFPB (the "Consent Order") highlighted instances where Regions did not identify those issues in a timely manner or did not go far enough once they became apparent:

1) While Regions had assembled a Working Group soon after the Opt-In Rule was adopted, and several months before it became effective, the Working Group did not properly include linked checking accounts (as described above) as subject to the Opt-In Rule.

2) Once those accounts were identified as subject to the Opt-In Rule (13 months after the compliance date), the issue was not elevated to the Legal Department (who addressed it with senior executives) until approximately 8 months later.

3) During that time the accounts continued to be improperly charged overdraft fees, until two months after the elevation to Legal.

As a result, Regions originally identified 198,387 customers who were due reimbursement totaling $34,946,530. After further review by the CFPB, that number of customers and reimbursement amount increased, with almost $49 million due to be reimbursed as presented in the Consent Order. That amount may increase further still, as the Consent Order also requires Regions to hire a third-party consultant (subject to approval by the CFPB) to ensure all improperly charged customers receive restitution; in addition, any negative reports to credit agencies that were due to those fees must be identified and corrected by Regions. Finally, the CFPB levied a $7.5 million civil penalty against Regions – not only for the violations of the Opt-In Rule, but also for the "deceptive acts or practices" of charging fees inconsistently with marketing materials and customer communications.

Beyond this direct action against Regions, the CFPB spoke directly to consumers with a simultaneously-released Consumer Advisory explaining customers' rights with respect to overdrafts and overdraft fees. As your customers may be reviewing this document and using it to ask questions, you may want to become familiar with the points made by the CFPB – particularly since, consistent with prior communications, the CFPB provided within the Advisory information for customers to submit complaints directly to the CFPB. The CFPB provided links to other overdraft information and analysis in the press release announcing the Regions action (including, for example, its July 2014 Overdraft Data Point), but you may want to review the Winter 2015 Supervisory Highlights – this document discusses other practices, such as insufficiently-disclosed changes in calculating customers' available checking balances, which a) were found to be deceptive and b) may be on the CFPB's overdraft radar.

May 20, 2015

Previous updates have discussed the upcoming TILA/RESPA integrated disclosure (TRID) compliance deadline of August 1, 2015, as well as issues that may warrant particular training and policy/procedures changes (including servicing, homeownership counseling, and advertising) as lending practices are reviewed and revised in preparation for that deadline. Recent guidance from the Consumer Financial Protection Bureau provides another area for attention – consideration of income from the Section 8 Housing Choice Voucher (HCV) Homeownership Program.

In a May 11 announcement, the CFPB released Bulletin 2015-02, which provides guidance on the appropriate consideration of such income in mortgage lending decisions. The CFPB outlines in that Bulletin the following specific prohibited practices identified which have resulted in the Bulletin's issuance:

1) "[I]nstitutions excluding or refusing to consider income derived from the Section 8 HCV Homeownership Program" in the application/underwriting processes; and

2) "[Restricting] the use of Section 8 HCV Homeownership Program vouchers to only certain home mortgage loan products or delivery channels."

As further explained by the CFPB, such "protected income" may not be automatically discounted or excluded – the individual applicant's actual circumstances must form a basis for any discounting/exclusion.

Therefore, given that the Equal Credit Opportunity Act and Regulation B both prohibit discrimination against a borrower on the basis of the borrower's income deriving in whole or in part from public assistance programs (such as the Section 8 HCV Homeownership Program), the above actions may result in prohibited disparate treatment. More broadly, "ECOA and Regulation B may also be violated if an underwriting policy regarding income has a disproportionately negative impact on [such] a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face." To manage this risk, the CFPB also provides the following suggested practices:

1) "Clear articulation of underwriting policies regarding income derived from public assistance programs;

2) [T]raining of underwriters, mortgage loan originators, and others involved in mortgage loan origination; and

3) [C]areful monitoring for compliance with such underwriting policies."

As part of any loan process review to prepare for TRID, a review and revision of applicable policies and procedures (and training on same) to address these concerns raised by the CFPB would be warranted – particularly given the corresponding post to consumers on the CFPB's blog, and the continued attention by the CFPB to fair lending issues in general.

June 3, 2015

Additional guidance regarding compliance with fair lending laws and regulations was provided last week by the Consumer Financial Protection Bureau, in the form of a complaint and corresponding proposed consent order involving Provident Funding Associates (Provident). In a May 28 announcement, the CFPB detailed the results of its investigation with the Department of Justice against Provident for charging higher broker fees on certain mortgage loans in violation of both the Equal Credit Opportunity Act and the Fair Housing Act. The penalties imposed in the consent order (pending approval by a U.S. District Court) included $9 million in damages, to be placed in escrow and overseen by a Settlement Administrator.

The details of the complaint and proposed consent order, however, provide useful information regarding measures that the CFPB considers appropriate to ensure compliance with fair lending laws and regulations, which banks should consider when evaluating their own fair lending efforts. In the former category, the CFPB criticized the subjective discretion provided to mortgage lenders by Provident during the review period, but also highlighted the objective, across-the-board compensation approach subsequently adopted by Provident as reflected in the consent order. The CFPB also emphasized the particular equal credit opportunity training implemented by Provident, provided "to its management officials or employees who: (a) have responsibility for interacting with mortgage brokers; (b) have responsibility for conducting fair lending compliance monitoring or for reviewing fair lending complaints; or (c) have responsibility for ensuring that mortgage brokers' compensation complies with Provident's policies and procedures as well as federal and state statutes and regulation," as well as the specific monitoring implemented with respect to any significant pricing disparities identified.

As with the other recent guidance from the CFPB on mortgage lending highlighted in prior updates, a review and revision of applicable policies and procedures (and training on same) to address these concerns raised by the CFPB would be recommended.

June 17, 2015

In an earlier update, we discussed application of HIPAA (Health Insurance Portability and Accountability Act) and HITECH (Health Information Technology for Economic and Clinical Health Act) requirements to banks as business associates of "covered entities" as defined by HIPAA (e.g. healthcare providers), as well as the upcoming HIPAA compliance audits of such business associates announced by the Department of Health and Human Services' Office of Civil Rights ("OCR"). Recently, the OCR began sending surveys to both covered entities and business associates as part of their sample selection process for those planned compliance audits - it is expected that up to 500 covered entities and 200 business associates may receive these surveys.

As a reminder, should a bank be considered a business associate under HIPAA specific regulatory responsibilities attach to that bank, such as conducting a risk analysis with respect to protected health information ("PHI"), implementing appropriate physical and technical controls, and execution of business associate agreements with its subcontractors who may receive or transmit PHI from the bank (such as shredding companies). Specific training for those individuals involved in handling PHI, including management, is also required, along with a policy to impose appropriate sanctions on those individuals who fail to comply with policies related to the security of PHI. In addition, the specific business associate agreement(s) signed by the bank may require notice be provided to the covered entity client much more quickly than the period allowed under the regulations, which may require the bank's existing information security breach identification and response policy to be adjusted accordingly.

If you have not recently reviewed your status as a business associate, and/or your compliance with the requirements attached to that status, now would be the time – as we previously mentioned at least one bank regulatory agency has already begun reviewing bank HIPAA compliance outside of the OCR audits, and the distribution of these surveys may prompt questions from covered entity clients themselves as to the banks' readiness.

More recently (i.e. yesterday), the Office of the Comptroller of the Currency released the "Residential Real Estate Lending" booklet (the "RRE Booklet") of the Comptroller's Handbook (replacing guidance previously issued in 1990 and 1998) to provide guidance to OCC examiners and bank personnel with respect to the OCC's review and supervision of a bank's RRE lending activities. While the RRE

Booklet does not go into a great deal of detail on either qualified mortgage requirements or the upcoming TILA/RESPA Integrated Disclosure (instead referencing the CFPB's rulemaking or other OCC guidance), it does provide some information regarding the OCC's supervision of non-qualified mortgages through a specific section in the Internal Controls Questionnaire provided in the Booklet. As with the other recent guidance on mortgage lending highlighted in prior updates, for those banks supervised by the OCC a review and revision of applicable policies and procedures (and training on same) to ensure consistency with the RRE Booklet would be recommended.

July 2, 2015

Two significant developments occurred on June 25, and while one may have been overshadowed by the other, both deserve your attention.

Of primary importance to most banks was the long-awaited decision in Texas Department of Housing and Community Affairs et. al. v. Inclusive Communities Project, Inc., et. al., which held that housing practices and policies may be challenged under the Fair Housing Act (the "FHA") on the basis of disparate impact (or specifically that "Disparate-impact claims are cognizable under the Fair Housing Act," per the syllabus to the opinion). The Supreme Court (the "Court"), however, provided some limits to liability under disparate impact claims. First, the Court indicated that a statistical difference (such as that relied upon by the District Court in the case) is not sufficient, specifically requiring that the disparate impact result from "[a] policy or policies causing that disparity." In addition, the Court focused on the language of the FHA and similar statutes (specifically, "catchall" provisions such as the FHA's "otherwise make unavailable" clause) in finding that the FHA was intended to address "the consequences of an action" and not simply the intent behind such action. While there is no such "catchall" in the Equal Credit Opportunity Act, the Court did suggest that such language was not a prerequisite for a statute's coverage of disparate impact claims, and so the impact of that focus on such catchall provisions is still unclear.

Also on June 25, however, the narratives of complaints posted on the Consumer Financial Protection Bureau's website became public (per an announcement on Thursday). As discussed in a prior Compliance Update, earlier this year the CFPB announced a policy change to permit customers of financial institutions to opt-in to making their complaint narratives public. Those narratives are now available here. The CFPB has already indicated in their most recent Supervisory Highlights that complaints have not been sufficiently monitored – as such, some regular review of this database (particularly given the publicly-available details of complaints filed) is certainly recommended.

July17, 2015

Two significant developments in cybersecurity have come about since the end of June. On June 30, the Federal Financial Institutions Examination Council (FFIEC) released its Cybersecurity Assessment Tool to provide bank management with guidance as to a) the identification and mitigation of various systems/technological risks that may be present in a bank's services and service providers and b) supervisory expectations with respect to same. The tool itself consists of multiple components, which are summarized and walked through in the FFIEC's presentation on the tool located here. A detailed process flow is also provided on the Tool's webpage. Importantly, the OCC, FDIC, and the Federal Reserve have all indicated that the assessment tool will be incorporated into their exam processes, so understanding and implementation of the tool by bank management will likely be an important part of preparation for upcoming regulatory examinations.

Additional cybersecurity guidance in June, relating to governmental information, came from the National Institute of Standards and Technology (NIST). NIST recently released Special Publication 800-171, containing new requirements for federal agencies regarding the protection of controlled unclassified information ("CUI" - defined as "information that requires safeguarding or dissemination controls pursuant to and consistent with applicable law, regulations, and government-wide policies but is not classified under Executive Order 13526 or the Atomic Energy Act, as amended") held by federal contractors. 800-171 specifically includes "recommended requirements to protect the confidentiality of CUI residing in nonfederal systems and organizations consistent with law, regulation or government-wide policy," including but not limited to:

- Access control and limitation to authorized users only, including appropriate user identification and authentication;
- Training on the security risks involved with such information;
- Appropriate incident identification and response systems;
- Assessment of the risks and security controls associated with the information and associated organizational elements; and
- Appropriate physical and personnel security.

As further clarified in 800-171, "[these] requirements are intended for use by federal agencies in appropriate contractual vehicles or other agreements established between those agencies and nonfederal organizations." Banks involved in such contractual relationships should be aware that these may represent expectations and/or required terms of contracts with federal counterparties in any negotiations or renegotiations of those relationships.

July 29, 2015

Lending to military borrowers has for years been subject to additional requirements and restrictions. This month, governmental agencies added many additional requirements and restrictions – as well as expectations - with respect to such lending.

1) On July 22, the Department of Defense (DOD) finalized the revisions to the regulations implementing the Military Lending Act (MLA) which greatly expanded the scope of the MLA. As a result of the revisions, the categories of credit previously covered by the regulations – certain payday, title, and tax refund anticipation loans – were broadened to include, among other products, credit cards, installment loans, unsecured open-end lines of credit, and private student loans. The coverage limits the ability to sell various "add-on" products, as most would result in an interest rate above the Military Annual Percentage Rate (MAPR) limitation of 36% set by the regulations, and further differentiates the MAPR calculation methodology from that used to calculate APR under Reg Z. The regulations also require additional disclosures at the inception of a transaction and impose additional penalties for failure to comply.

2) Regarding private student loans specifically, the Consumer Financial Protection Bureau also released in July a follow-up to its October 2012 report The Next Front? Student Loan Servicing and the Cost to Our Men and Women in Uniform, which detailed issues servicemember borrowers faced with respect to their student loans and the protections of the Servicemembers Civil Relief Act (SCRA). The companion report issued on July 7, Overseas & Underserved: Student Loan Servicing and the Cost to Our Men and Women in Uniform (the Overseas

Report), provided additional barriers and difficulties identified by the CFPB with respect to such borrowers, including;

(a) Insufficient communication on military deferment;

(b) Failure to provide necessary information or process paperwork prior to deployment;

(c) Lack of explanation for denial of deferment;

(d) Differing application criteria, policies and procedures;

(e) Poor communication by servicing personnel related to the processing of Student Loan Repayment Program payments; and

(f) Disruption or discontinuation of military benefits resulting from servicing transfers.

In closing the report, the CFPB states that "there is currently no comprehensive statutory or regulatory framework that provides uniform standards for the servicing of all student loans," and reiterates that they "remain particularly attuned to the serious and significant problems facing servicemembers repaying student debt."

As banks prepare for the MLA regulations' compliance date of October 1, 2015 (although most changes apply to credit extended to covered borrowers on or after October 3, 2016) and compare their practices to the new restrictions imposed by the DOD, some consideration should also be given to the specific issues identified by the CFPB in the Overseas Report. At the very least, those issues (which were identified primarily through a review of customer complaints) may provide common weaknesses in military lending practices that lending and operational departments should be attentive to. Further, as the issues identified may now represent "known quantities" of issues for the CFPB (and by extension other bank regulators), greater attention may be paid to such issues by such regulators during their examination cycles. Banks may also consider reviewing their compliance management systems for appropriate coverage of SCRA and MLA issues - earlier this year one bank's SCRA issues ultimately resulted in a consent order requiring, in addition to a $30 million civil penalty, revision of the bank's enterprise-wide compliance risk management program.

August 13, 2015

The Basics of Networking Arrangements

We discussed in an earlier update FINRA Rule 2040, which was adopted in March of this year and which explicitly prohibits FINRA firms (and persons associated with FINRA firms) "from, directly or indirectly, pay[ing] any compensation, fees, discounts, commissions or other allowances to" any party that would be required to be registered by the SEC to receive such compensation, and also provides guidance for when FINRA firms decide to make payments to third parties (which may include those banks engaged in networking arrangements with broker-dealers). Banks often enter such arrangements to provide bank customers with access to products that the bank itself cannot offer; those arrangements may include bank employees becoming registered with the broker-dealer and acting as such on bank premises. While the aforementioned rule limiting compensation paid to non-broker dealers or their personnel (such as banks or bankers) becomes effective this month, other limitations and requirements for relationships between banks and broker-dealers have already been in effect, and may trip up those banks and bankers not expecting them.

In January of this year, the Office of the Comptroller of the Currency issued a revised "Retail Nondeposit Investment Products" booklet, which includes the Interagency Statement on Nondeposit Investment Products from 1994 (the IAS) and subsequent laws and regulations, including Regulation R (which limits the permitted securities activities of and securities compensation paid to nonregistered employees) and Regulation P (which establishes particular information sharing restrictions to protect customers' financial privacy). The booklet itself can be found here – while the specific requirements for engaging in such activities are often many and varied, they are derived from certain basic principles:

1) **The bank and the broker-dealer are separate entities**. As detailed in the booklet, there are restrictions on the types of products and services banks can offer their customers. Any products outside of those approved types must be offered by another type of entity (such as a broker-dealer) – even if on bank premises and under a bank-branded line of business (for which there are specific restrictions under the IAS and Reg R). As bank customers may not always realize the difference, banks should ensure that the distinction is made at least to the extent required by the IAS and by Reg R (e.g. physical separation of investment activity from deposit-taking, clear indication that the bank is not offering brokerage services) and reinforced by those individuals selling the products and services.

2) **Bank employees are not always acting as bank employees.** If any bank employees become registered representatives of a broker-dealer, then with respect to those products that are offered by the broker-dealer they are just that – representatives of the broker-dealer. This becomes significant, for example, when those employees may have access to bank customer information in their roles at the bank which those customers have not consented to share with the broker-dealer. Banks are at a minimum required by the IAS to adopt policies and procedures to address the permissible use of customer information – in developing such processes, banks should consider not only "hard access" (i.e. specific system access) but also "soft access" (e.g. inclusion on e-mails and in meetings where such information is available). In addition, such employees should have specific job descriptions establishing their responsibilities for the bank, particularly if they are involved in any area or activity where they may have access to such information.

3) **These distinctions should be established from the outset**. The IAS and subsequent guidance establish particular requirements for any networking agreement between a bank and a broker-dealer, including the ability of the bank to monitor the broker-dealer's compliance with the agreement. In addition, the IAS requires that written contracts be in place between the broker-dealer and the bank employees who will be registered with it. Bankers should be aware that some of these agreements include non-solicitation clauses limiting the ability of the representative to solicit clients of the broker-dealer should the representative's registration be terminated. As indicated in 1) above, the customer agreements for nondeposit products may be between the broker-dealer and the individual customers – any such nonsolicitation clause may be problematic for the banker looking to continue a relationship with that client once that banker is no longer registered with the broker-dealer in question.

4) **Ongoing monitoring is essential.** As indicated in 3) above, regulators expect a bank to have the contractual ability to monitor the performance of a broker-dealer with which the bank is engaged in a networking relationship. This may include a review of compliance reports

focusing on the bank employees registered with the broker-dealer, a review of financial results and patterns of products sold, and regular reports of customer complaints about the registered bank employees received by the broker-dealer. In addition, the performance of the bank in the relationship should also be reviewed, to ensure that the various lines established for the bank and its employees in the relationship (whether by law, regulation, policy/procedure or the agreement with the broker-dealer) are not crossed.

Networking arrangements can add a new dimension to the customer experience, but should not be engaged in lightly. If the relationship is established appropriately from day 1, with everyone - including the bank, the broker-dealer, and both registered and non-registered employees involved in the process (who must be aware of the limits to the assistance they can provide with respect to such products) – on the same page, both the bank and its customers may receive the benefits expected from that relationship.

August 26, 2015

Ground-Level Data Security

In earlier updates we've discussed various expectations of regulatory agencies and examiners with respect to a bank's cybersecurity responsibilities, including those specific expectations for board and management involvement, as well as tools and guidance from governmental agencies to assist boards and management in meeting those expectations. However, all bank employees have a role to play in cybersecurity – given that a recent survey of data security incidents found that 31% of the breaches identified were the result of negligent employees, it's likely that without training your employees may actually work against the efforts of the board and management without meaning to.

While the guidance from the Federal Financial Institutions Examination Council (FFIEC) (see here for example) provides requirements for the structure and elements of a program, there are some particular areas that are not always addressed that can expose a bank to greater risk than necessary of an information security breach:

1) **Look at employees' total access to information – not just what systems they can log into**. Most reviews of employee access to information focus on so-called "hard access" – i.e., what systems employees have been given access to via a login/password, whether to enter, modify, or simply review the information within those systems. What is not always identified or controlled is what may be termed "soft access" – that access to information provided to employees outside the context of direct systems access. This includes the following:

    (a) Hard-copy reports received via verbal or other request, e.g. in the context of an internal audit or marketing distribution;

    (b) Electronic reports received by employees copied on e-mail "for convenience" or "just to be kept in the loop;" and

    (c) Reports received at meetings to which employees may be invited to, "so they know what's going on."

Note that not all soft access is inappropriate – some may be necessary for an employee's job function – but in some cases the recipients of the information not only don't need the information, they may not be used to the appropriate controls required for handling such information (e.g. protected health information as defined by HIPAA) and inadvertently expose it to inappropriate access or disclosure.

2) **Establish appropriate, educated access at each point in an employee's career.** When an employee begins work, access to various bank systems (including the internet and e-mail, when appropriate) is typically provided based upon a system access authorization form completed by the hiring manager. While that initial access list may be based on the employee's job responsibilities at that point in time, changes to an employee's job responsibilities do not always result in appropriate changes in access. For example, if an employee moves from an internal accounting role (where knowledge of the salaries of various employees is appropriate and necessary for her job) to an external sales role, it's important that the previous access be revisited and revised to prevent her from inappropriate access to payroll information that is now no longer necessary for her job. Similarly, when an employee terminates, accurate documentation of systems access is important to ensure that all such access is shut off at the appropriate time to prevent e.g. theft of proprietary information. Along with access, it's important to provide employees with knowledge of the bank's internet and e-mail usage policy to avoid inappropriate communications from the bank's address. More importantly, the employee may not be aware of the new methods used by hackers to gain access to bank systems (e.g. spear phishing – targeted e-mails from a familiar web address with links to bogus websites used to gain login credentials) – appropriate training before such access is given can reduce the risk of an employee (and by extension the bank) falling victim to such scams.

3) **Understand employees' mobile device expectations – and make sure they know yours.** As many companies utilize a "bring your own device" approach, the risks of sensitive data remaining on such devices e.g. via e-mail should be addressed even before an employee is hired. Some discussion as to a potential hire's use of remote access or mobile devices may highlight some practices that should be monitored (or even changed) if the employee is hired. Given that some organizations limit remote access to particular devices, it may be worthwhile to confirm that the "brand new laptop" the recruit just purchased will work within your bank's systems to avoid any difficult post-hire discussions. As with e-mail and internet usage described in 2) above, some training as to company expectations regarding mobile device security – both physical and technical – is important; while you may not think it necessary to instruct an employee not to leave a device containing sensitive information on the front seat of his car, experience has shown that sometimes such instruction has to be provided. Similarly, as some mobile applications may send files outside of a company's e-mail network even if connected to the network, employees should be aware of processes for sending confidential, privileged and sensitive information to avoid any inadvertent breaches "via app."

Information security breaches may not be completely prevented, but an informed workforce can certainly assist the board and management of a bank in meeting their responsibilities regarding cybersecurity. In addition, the more comfortable employees are in discussing the issue, the better ambassadors of bank practices they can be with customers who may have questions or concerns about those practices – ambassadors that may help to turn those concerns into confidence in the bank's protection of their information.

September 11, 2015

Make Sure Your Policies and Procedures are Your Policies and Procedures

We’ve discussed in earlier updates the upcoming TRID transition date, as well as various other enforcement actions and communications from the CFPB, which should prompt a review of your policies and procedures to ensure coverage of these new requirements. Faced with the time and effort which may be involved in revising and/or drafting multiple documents, many banks have turned to third-party providers for policies, procedures or entire manuals, to supplement and/or replace their current documents. These ready-made manuals can often be a good way for banks to conserve internal resources and still fill in the gaps in their internal processes. However, before you “open the box” and begin to upload, distribute or otherwise implement these new policies and procedures, there are certain elements of your new manuals that should be reviewed to ensure not only that your business is accurately reflected, but also that you’re not placing unnecessary restrictions on that business:

1) **Does the corporate structure within the manual reflect yours?** Some manuals are developed around a standard corporate model, with references to commonly-utilized committees and job titles, which may not necessarily be the committees or positions that are present in your organization. If a critical function is assigned to a (for your bank) non-existent committee, you may spend more time explaining to an examiner ”how the process really works” – and responding to an examination comment resulting from that conversation – as you would have drafting that particular policy internally.

2) **Is the governing authority referenced and cited applicable to your bank?** As with corporate structure, some manuals are built around federal and state statutes and regulations that commonly apply to most banks (or larger banks). Your community bank may not be subject to supervision by the Office of the Comptroller of the Currency, for example, but the manual you purchase may include references to or restrictions based upon specific OCC regulations and/or guidance. Similarly, some manuals include references to specific state laws and regulations which may not be applicable to your bank, and as such may be overly restrictive and unnecessary.

3) **Are your business processes and products accurately reflected?** Many ready-made manuals address all of the different types of products a bank may offer, which may not necessarily be reflective of your offerings. If too many products are included, you may end up explaining to a customer that you don’t actually offer a product that an employee mentioned to them “because they saw it in the manual” – or explaining to an examiner that your product offerings haven’t actually changed, as you represented in your last communication with that examiner, even though your manual says otherwise. On the other hand, if some of your products aren’t included, or if there are affirmative statements indicating that you don’t offer some of the products that you actually do (e.g. “It is the policy of [bank] to not offer reverse mortgages to our customers) – you may similarly be faced with employee conversations about lost opportunities (“Our policy said we didn’t offer those”) or examiner conversations about policy violations resulting from products you’ve sold for years.

Externally-produced policy and procedure manuals can provide a great deal of value to banks with limited resources. Careful review of those manuals before implementation can help to ensure that the resources you save in drafting the manuals aren’t simply spent later on explaining them.

September 24, 2015

New Mortgage Developments: Realtor Expectations and New Mortgage Complaints

As we approach the TRID effective date, the Consumer Financial Protection Bureau has reached out to consumers and realtors with information that banks should be aware of, given the impact on the expectations of these parties involved in the mortgage process:

1) From the consumer standpoint, the CFPB just released the September 2015 Monthly Complaint Report, with the focus this month on mortgage complaints. As explained in the CFPB's release of the report, mortgages have generated more complaints to the CFPB than any other financial product, with 192,500 complaints begin handled by the CFPB as of September 1, 2015. Issues identified include the following:

    (a) Most complaints involve issues faced by borrowers when they are unable to continue payments, including delays in the modification process and the timing of foreclosure proceedings.

    (b) Servicing transfers continue to cause problems for consumers, including a lack of notice of the transfers and increased payments resulting from them

    (c) Additional complaints involve confusion regarding partial payments or the misapplication of payments among principal and interest.

    As for the data in the report (based on an average of the preceding three months, June-August 2015), the overall complaint volume in Oklahoma increased 12% from the same period last year and the mortgage complaint volume from June-August 2014 to June-August 2015 increased 42% (the fourth-largest increase noted).

2) In addition, the CFPB has provided information to realtors in the form of "The real estate professional's guide," located here. As with similar guidance for banks, the guide sets out the various steps in the mortgage process and highlights the responsibilities of realtors in that process. Coordination of activities with banks is discussed as well (example below):

Find out who will be preparing and providing the Closing Disclosure, when and how your client can expect to receive it, and how any last-minute changes are handled. Business practices can vary from lender to lender and state to state.

Previously HUD-1 Settlement Statements were most often provided by a settlement agent, attorney, or closing company. This may not be the case for the Closing Disclosure. Lenders may choose to prepare and deliver the Closing Disclosure to your client directly. They may deliver it through the mail, in-person, or electronically (if your clients have given permission for electronic delivery).

Find out if the lender or the closing company has a required timeframe for any change requests. Keep in mind that no matter who prepares or provides the Closing Disclosure, the lender is accountable for its accuracy and approves the final version.

Given that the banks' involvement (and responsibility) is discussed, some review of the information provided to realtors is recommended to ensure a common understanding of the particular steps involved to avoid confusion and any improper delays.

While most banks are already stretched thin in developing forms and processes for TRID, some attention should be paid to the development of the expectations of their customers and other parties as the transition date approaches. Knowing what may be asked, or expected, of the bank in the mortgage process going forward may help provide some additional needed detail to procedures and processes, and may also help to prevent the types of complaints that the CFPB has already indicated are on their radar.

October 9, 2015

Fair Lending Developments – From Origination to Impact

Two recent fair lending developments indicate an increasing breadth to the types of issues and impacts triggering legal and regulatory action.

1) On September 24, 2015, the Consumer Financial Protection Bureau (CFPB) and the Department of Justice (DOJ) filed a complaint against Hudson City Savings Bank alleging various violations of the Equal Credit Opportunity Act and the Fair Housing Act. Those allegations included the following (more details are found in the complaint):

    (a) The bank placed branches and loan officers primarily outside of minority neighborhoods.

    (b) The bank excluded many minority neighborhoods from its Community Reinvestment Act assessment areas.

    (c) The bank focused its marketing efforts in neighborhoods with low minority populations.

    (d) While the bank had a fair lending policy, it had no corresponding written policies or procedures to monitor its fair lending compliance.

    As part of the resulting consent order proposed by the CFPB and DOJ, the bank would have to retain a third-party compliance management consultant (acceptable to the CFPB and DOJ) to assist the bank in revising its compliance management system. In addition, the bank would invest $25,000,000 in a Loan Subsidy Program to increase lending to the affected minority areas, and spend at least $200,000 per year on advertising to those areas.

2) Earlier this month, a federal appeals court ruled that fair lending lawsuits brought against three major banks by the city of Miami – based on the impact of the banks' lending decisions **on the city** could proceed. The city alleged that, as a result of the banks' targeting unqualified borrowers with higher-risk loans (which were ultimately foreclosed), the city experienced lower tax revenues and increased costs for services. While lower courts had dismissed the suits, a three-judge panel of the 11th U.S. Circuit Court of Appeals found that Miami did have "constitutional standing" to pursue its claims under the Fair Housing Act.

As these actions suggest, regulators – and courts – are entertaining more and varied theories of liability under fair lending claims, from the basis for origination efforts to the impact of a lending decision on parties outside the transaction. More than ever, banks should regularly review both the structure and components of their fair lending programs, and ensure coordination across the bank – as indicated above, the CRA and marketing areas should be involved as well. In addition, banks should document the ultimate outcome of their efforts, and have the data to back up any assertions that may be made to regulators in examinations - or in court.

October 23, 2015

Marketing Services Arrangements – Front to Back

The Consumer Financial Protection Bureau (CFPB) recently issued a compliance bulletin on Marketing Services Arrangements (MSAs) and particular issues they raise with respect to the Real Estate Settlement Procedures Act (RESPA), which should cause banks to review any such arrangements in which they are engaged. Under an MSA, a bank may contract with another settlement services provider to receive specific, targeted marketing services for mortgage customers. Those relationships, however, carry particular risks to banks, including the following highlighted by the CFPB in the bulletin:

1) "MSAs appear to create opportunities for parties to pay or accept illegal compensation for making referrals of settlement service business," in that customers may be steered to higher-priced mortgages as a result of these arrangements, and/or that services contracted for are not actually received (resulting in the "reasonable inference…that the MSA is part of an agreement to refer settlement services in exchange for kickbacks").

2) "[E]fforts made to adequately monitor activities that in turn are performed by a wide range of individuals pursuant to MSAs are inherently difficult" - in the examples cited by the CFPB, the difficulty for banks comes not only from monitoring their own compliance with RESPA but also that of the vendors with whom they have entered MSAs.

Of greater importance to banks involved in MSAs, however, may be the comments by the CFPB regarding their experience with and approach to MSAs:

1) The CFPB has received a good deal of information about the problems caused by MSAs, but not about the benefits such arrangements may provide.

2) From what the CFPB has seen, many MSAs are designed to avoid particular prohibitions of RESPA.

3) The nature of MSAs requires an individual review to determine if an MSA violates RESPA.

The last point above demonstrates the general skepticism with which the CFPB approaches MSAs, and which should inform not only a bank's decision to enter into any new MSA but also to scrutinize existing MSAs for appropriate structure and operation. As indicated in the bulletin, such a review should include both "the facts and circumstances surrounding the creation of" an MSA "and its implementation" – the CFPB cautions banks that the risks of actions taken under an MSA that may result in RESPA violations are typically high "even where the terms of the MSA have been carefully drafted to be technically compliant with the provisions of RESPA." For the CFPB, ensuring that an MSA is set up properly is not sufficient – some regular oversight of the operation of the MSA, and the activities of the counterparty to the MSA, is expected as well.

Lastly, the CFPB states that "a more careful consideration of legal and compliance risk arising from MSAs would be in order for mortgage industry participants generally," and that ongoing scrutiny of MSAs will be continuing by the CFPB. Banks would be advised to revisit their MSAs, and the processes around them, as this scrutiny is likely to increase.

November 6, 2015

Credit Card Lending: New Guidance and Complaint Caution

With TRID now one month in, regulators have turned their attention as of late to credit card lending:

1) Yesterday, the Office of the Comptroller of the Currency released a revised "Credit Card Lending" booklet for the Comptroller's Handbook. The booklet incorporates current statutes, regulations and guidance, and also provides "updated guidance for examiners on assessing and managing the risks associated with credit card lending activities." Community banks currently contracting with third-party credit card service providers would be advised to review the specific examination procedures for such relationships, found on pages 100-103 of the booklet – these include specific expectations regarding initial due diligence, contract terms, and monitoring of vendor performance. The OCC also provided Word versions of some of the sample forms, to be found here.

2) In addition to the OCC's guidance, the CFPB has released the latest Monthly Complaint Report, with the focus this month on credit card complaints. The CFPB highlighted the following issues noted by consumers:

    a. Confusion on how late fees are assessed, including a lack of clarity regarding payment cut-off times;

    b. Confusion over the terms of deferred-interest programs;

    c. The lack of ability for consumers to allocate credit card payments as they would like, particularly regarding interest rate promotions with differing expiration dates;

    d. Closure of accounts with customer knowledge or consent (typically when default or suspected fraud is involved), or failure to close an account when requested to do so by the consumer; and

    e. Failure to notify consumers that their credit limits could be reduced without advance notice.

    As for the data in the report (based on an average of the three months from July-September 2015), the overall complaint volume in Oklahoma increased 12% from the same period last year while the overall complaint volume dropped 9% between August and September 2015.

3) Lastly, from a broader perspective, the Comptroller of the Currency discussed on November 2 the overall increasing credit risk facing the federal banking system. The remarks, delivered to the RMA Annual Risk Management Conference, highlighted the areas in which the OCC is seeing increased credit risk being taken on by banks – which may also indicate future examination priorities going forward.

November 20, 2015

Information Security Policies – Just In Time for the Holidays

As we approach Black Friday and the official start of the Christmas shopping season, it may not seem to be the best time to remind employees of bank policies, but in the case of your bank's information security policies it may be the best time.

We've discussed in earlier updates the expectations of financial regulators with respect to bank cybersecurity efforts, including the recently-issued cybersecurity assessment tool from the FFIEC. As the FFIEC has discussed in their Information Security IT Booklet, a key element of those efforts is a sound information security policy structure, which often includes an Acceptable Use Policy. Such a policy is intended to ensure appropriate use of the bank's technology, including hardware, software, networks, and telecommunications – including access of those networks by employee-owned devices.

So why is now a good time to remind employees of such a policy? Holiday shopping often results in new devices – devices which many bank employees can't wait to bring to work to utilize on the job.

- If you don't currently have an acceptable use policy, now is a good time to develop one to address the risks that such devices prevent.
- If you do have such a policy – whether it is general and case-by-case with respect to approval of employee-owned devices, or establishes particular requirements for such devices, some reminder to employees of that approval process - **or -** restriction may prevent some unpleasant post-holiday discussions.
    - o As an example, some banks have prohibited devices using certain operating systems from accessing their networks due to security concerns – employees that showed up to work with brand new phones or tablets using that system were disappointed to find that those devices had to remain "for personal use only."
    - o Similarly, employees that anticipate working offsite with such devices should be reminded of your particular remote access policies, in the event that they are unable to take advantage of them.

All of the technological developments available to bank employees can motivate and inspire them to find new efficiencies and motivations to accomplish the bank's goals and objectives. It's important, however, that those developments comply with the bank's cybersecurity policies - and that employees are aware of what those policies require.

December 10, 2015

New Complaints and Future Concerns

In recent publications and public comments, the CFPB has highlighted existing and upcoming areas of focus for their scrutiny. While TRID has been of primary concern, the CFPB has provided reminders that many other issues are in their radar:

1) Regarding current issues identified in consumer complaints, the CFPB just released the November 2015 Monthly Complaint Report, focusing on complaints with bank accounts and associated services. Prepaid accounts experienced the highest increase in complaint volume, both over the prior year (193% increase since August-October 2014) and from month to month (396% increase from the prior month). The particular issues identified include the following:

    a. With respect to account management (44% of bank account/service complaints reported):

i. Denial of the ability to open an account without a clear indication as to the reason for the refusal, and difficulties in opening accounts due to adverse credit reports resulting from identity theft, unrecorded payoffs, or other errors.

ii. Confusion as to the eligibility (or lack thereof) for bonuses, certain account features, and specific product promotions.

iii. Lack of reasons given for account closure.

iv. Inability to obtain resolution for disputed transactions, including ACH debits for cancelled transactions or the lack of provisional credit.

b. Regarding deposits and withdrawals (25% of bank account/service complaints reported):

i. Restricted access to funds, including holds at the time of deposit and extended holds placed after deposits were made without notice until receipt of the hold notice by mail.

ii. Early cut off times for same day deposits.

iii. Confusion over certain fees, including overdraft fees for checking accounts (some customers believed their refusal to opt-in to overdraft protection prevented such fees) and the impact of posting order on the charging of such fees.

As for the data in the report (based on an average of the preceding three months, August-October 2015), the overall complaint volume in Oklahoma increased **6**% from the same period last year and the bank account/service complaint volume from August-October 2014 to August-October 2015 increased **8**%.

2) Also in November, the CFPB published (on their blog) their Fall 2015 rulemaking agenda. Of note is the CFPB's consideration of proposed rules that would (in their words) "prevent companies from using [arbitration] agreements to foreclose consumers' ability to bring class action lawsuits, which can provide consumers with substantial relief and create the leverage to bring about changes in business practices." In addition, further rulemaking is indicated with respect to overdraft programs on checking accounts – the opt-in process for overdraft protection still being a concern for them.

3) More recently, at a mortgage conference in California a CFPB official indicated that the following four issues will be key areas of focus in CFPB examinations: loan officer compensation plans (both current and historical practices), compliance with ability-to-repay rules, compliance with TRID disclosure requirements, and the structure of marketing service agreements. In addition, the official stressed that with respect to TRID compliance the CFPB was not providing any grace period from compliance with the rule.

As with all complaints highlighted by the CFPB, banks are advised to consider their own experiences with such complaints in anticipation of any questions from regulators. Similarly, banks not subject to the CFPB's direct examination authority may feel the impact of that agency's examination priorities from their own regulators – or, ultimately, from new rulemaking prompted by the CFPB's findings

December 23, 2015

Future Concerns Part II: Commercial Real Estate Lending

While in a prior update we discussed issues on the Consumer Financial Protection Bureau's radar, the other banking agencies recently indicated one issue on theirs. On December 18, the banking agencies issued a statement on "Prudent Risk Management for Commercial Real Estate Lending" (the "Statement") highlighting particular agency findings and expectations regarding commercial real estate (CRE) lending practices. Specifically, the agencies identified in the Statement the following issues noted during examinations and outreach activities (from page 1 of the Statement):

1) Rising CRE concentration levels in many banks;

2) Easing of underwriting standards for CRE lending, including less-restrictive loan covenants, extended maturities, longer interest-only payment periods, and limited guarantor requirements; and

3) A greater number of underwriting policy exceptions and insufficient monitoring of market conditions for appropriate assessment of CRE risks.

Also within the Statement is a reminder of previously-communicated guidance from the agencies, "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" (the "Guidance"), and the expectations of the agencies that banks will appropriately implement the principles within that Guidance (from pages 2-6 of the Guidance):

1) **CRE Concentration Assessments:** Ongoing risk assessments to identify, assess, and monitor the risks of CRE concentrations.

2) **Risk Management:** Establishment of a risk management framework incorporating the following elements:

    a. Board and management oversight setting and implementing appropriate policy guidelines and CRE lending strategy (with necessary exposure limits).

    b. CRE Portfolio management, including evaluation of particular real estate sectors and their impact on the CRE portfolio as a whole.

    c. Management information systems to provide management and the board with enough information to identify, measure, monitor and manage CRE concentration risk.

    d. Market analysis to gauge the appropriateness of the bank's CRE strategy and policies in light of CRE market conditions.

    e. Credit underwriting standards that reflect the level of CRE risk acceptable to the board, including policies that address the following:

        i. Maximum loan amount by property;

ii. Loan terms, including pricing structures;
iii. Valuation issues, including collateral valuation and loan-to-value limits by property type;

iv. Requirements for feasibility studies and sensitivity/stress testing and analysis; and

v. Minimum borrower requirements, including A) initial investment/maintenance of hard equity and B) standards for net worth, property cash flow and debt service coverage.

f. Portfolio stress testing and sensitivity analysis to quantify the impact of changing economic conditions on asset quality, earnings, and capital.

g. Credit risk review to assess credit quality and identify problem loans.

Going forward, the agencies indicate in the Statement that banks' implementation of the above principles and other prior guidance (listed on page 4 of the Statement) will be a focus of examinations of CRE lending activities – in particular for those banks with CRE lending that has increased or is anticipated to do so. In addition, the regulators recommend that banks review their CRE lending policies and procedures and maintain appropriate underwriting and risk management practices to "identify, measure, monitor, and manage the risks arising from CRE lending activity." As banks that are found to have insufficient risk management or other expected practices may be asked to adjust them appropriately – or adjust their CRE portfolio or associated capital – some advance review in accordance with the Statement and the Guidance is certainly recommended.

Tom C. Vincent II

GABLE GOTWALS COUNSEL

Tom C. Vincent II brings extensive experience in banking, financial services, and trust company compliance to his practice at GableGotwals. His background includes serving as The F&M Bank and Trust Company's Chief Compliance Officer, where he chaired the bank's Compliance and Ethics Committee, implemented the bank's overall corporate compliance plan, including assessment and management of the bank's compliance risks as well as monitoring the bank's activities to ensure compliance with the various laws and regulations applicable to those activities. Tom also held several compliance-related positions with BOK Financial Corporation (BOKF) and its subsidiaries, including serving as Chief Compliance Officer for BOSC, Inc., BOKF's subsidiary broker-dealer, and also as Senior Vice President and the Manager of Corporate Governance and Wealth Management

Compliance. Additionally, Tom has experience in investment advisory and trust and fiduciary compliance, and has held various broker-dealer and investment advisory securities licenses. Tom also assists his clients with issues involving data security and privacy, including the establishment of data protection programs and breach identification and reporting.

Since 2007, Tom has presented with other attorneys on trust administration and compliance topics to audiences of attorneys, bankers, and trust professionals.

A Certified Regulatory Compliance Manager, Tom's hands-on industry experience helps him guide clients though the myriad of state and federal laws, regulations and requirements to ensure compliance and protect them from potential lawsuits and regulatory action.

Tom received his Juris Doctor from Washington and Lee University School of Law in 1994 and his Bachelor of Science in political science from Southern Methodist University in 1991.

He is a member of the Oklahoma Bar Association, Tulsa County Bar Association, the American Bar Association, the Society of Corporate Compliance and Ethics, and the Institute of Certified Bankers.

CBAO Weekly Compliance Updates
By Paul R. Foster, Paul Foster Law Offices, P.C.

January 14, 2015

Mineral Interests (fee simple owned minerals, not leasehold interests) owned by banks are a wonderful source of potential revenue. Especially when you didn't even know you owned the minerals until you were contacted about them! As many of you have heard me discuss before in various CBAO venues, these mineral interests may not be required to be removed from the bank, contrary to what you may have thought as a result of an examination or discussion with a regulator. It is true that mineral interests are treated as real estate which has to be completely written off after 10 years for both state and national banks and often it is brought up that the bank should not continue to own the minerals, lease them and receive revenue for these minerals and so they must go. If there is a way to keep them for the bank to help diversify the bank's income, it is likely worth exploring. There are various rules and requirements that must be followed in order to do so, however, and they most certainly are NOT simple or even published. For example, just signing a mineral lease or accepting a lease bonus or royalty payment may actually be a violation of law. If you have already done so, there may nevertheless be a way to bootstrap the transaction and avoid any issues. If you have minerals in your bank and would like to try to keep the minerals or legally move them to the shareholders, there are proper avenues for doing so. Even if you are actually required or simply want to move them out to the shareholders, there are right ways and very wrong ways to do this, e.g., simply acquiring them in a subsidiary or in the holding company is NOT likely to meet the requirements. But the simpler play may be to keep them in the bank and there often are legal ways of doing so.

January 28, 2015

DON'T SIGN REAL ESTATE DOCUMENTS AS CEO, CLO or CFO - Save money on legal fees by executing the bank's real estate documents only as a president, vice president, chairman or vice chairman.

Corporate real estate documents recorded in Oklahoma (such as deeds, mortgages, subordinations, mortgage assignments, extensions and releases) should be executed only by a president, vice president, chairman, or vice chairman on behalf of the corporation including the banking corporation. This is to satisfy the conveyances requirements in Title 16 of the Oklahoma Statutes (Title 16 O.S. §12.2). Execute instruments affecting conveyances of real estate and which are to be recorded as a Chief Executive Officer (CEO) has become more common as more community banks include a CEO position.

The CEO position is usually considered a "higher" position in a corporate hierarchy than "President" and so it is not unusual for bankers to think execution of a conveyance by the CEO is authoritative and more so than by a Vice President. However, execution of these documents by the CEO does not meet the conveyance requirements for corporate instruments and may create issues for the grantee of a conveyance as well as lost time and unnecessary legal fees after the fact, as your bank may get included in a foreclosure or quite title suit that could have been avoided by not having the CEO signed these documents.

Of course, often a CEO is also a President and a CLO or CFO is also a Vice President, and so if their president or vice president designation is stated instead of CEO, CLO or CFO, then the document passes muster and unnecessary legal expenses are avoided. A CEO who is also not a President should not sign these documents for the bank.

So make sure when your bank executes a real estate document that the title of President, Vice President, Chairman or Vice Chairman, is clearly reflected in the signature block to allow the reviewer of title to pass the conveyance on this point. “Branch President” or “Market President” has not always in the authors’ experience resulted in a pass from title examiners.

February 11, 2015

Q: Can an FDIC insured bank hire or continue to employ a convicted criminal?

A: Yes and No – but wait….

As down and out attorney Frank Galvin (played by Paul Newman) stated in the movie The Verdict, “it is a long road that has no turning.” It is possible for the most qualified candidate applying for bank position to have a conviction lurking in their background. If you find yourself faced with the situation where the best candidate for a position in your bank discloses in his/her job application that there is a shoplifting conviction from many years ago in his/her history, the bank cannot hire that most qualified candidate unless you obtain prior written consent from the FDIC.

Section 19 of the FDI Act is a federal banking statute that prohibits the bank from hiring or continuing to employ or engage a person with a criminal record involving dishonesty, breach of trust, or money laundering. This includes employees of your bank. It also includes institution-affiliated parties (attorneys, accountants, consultants and the like) if they participate in the conduct of the affairs of the bank. If the applicant has such a background and you still want to hire the individual, the bank must seek to obtain the FDIC’s written consent prior to allowing that person to participate in the conduct of the affairs of the bank.

There is a procedure for obtaining this prior approval from the FDIC. If you currently have an employee who meets these restrictions or wish to hire someone who does, you should contact your legal counsel right away to develop a strategy for complying with Section 19.

March 4, 2015

Mortgage Tax Overpayment?

If you are paying the mortgage tax on mortgages for ten years even if they have a shorter maturity date, you should consider reducing that to a shorter period. A common practice in banking in Oklahoma for mortgages was to pay the mortgage tax for 10 years even if the mortgage had a shorter maturity. The idea (simply stated) was that the bank might or might not renew the underlying loan and rather than having to keep filing mortgage extension notices of record, paying mortgage taxes over and over each year of renewal, and keep up with tracking all of that and risk losing enforcement of the mortgage position, just pay the mortgage tax for 10 years since the mortgage was legally enforceable for that period and don't worry about it.

However, the legal reason behind this was that the law recognized the mortgage as enforceable for ten years. That statute was changed sometime back to seven years from the maturity date. But in some banks or with some bankers, the practice was never changed, so some banks or bankers are sometimes paying for more years than necessary.

Again, the rule is that the mortgage is enforceable for seven years from the maturity date stated in the mortgage, so the bank should only pay the tax for the time period through seven years from the due date. So if it is a 1 year maturity date, purchase for no more than 8 years.

If no due date is ascertainable from the recorded mortgage, the period is 30 years from the recording date of the mortgage.

Of course any Extension that may be filed of record on the mortgage to extend the due date will require payment of the mortgage tax for the added period on the end to match the new maturity date + seven.

March 18, 2015

2015 Bank Exam – One KEY Area of Focus from Federal Bank Examiners You May Not Expect:

Expect some additional focus from examiners in the areas of IT and Cyber Security in the next bank examination cycle or two (or twenty!). Do not assume this is taken care of by IT people just because they know more technical stuff than you. A bank's presence on the Internet is a choice made by management that creates vulnerability that could be attacked at any time with serious consequences, and unless senior management and the board of directors has some understanding of the threats and the risks posed for the institution, they cannot provide the necessary leadership in establishing goals, setting priorities and exerting fiscal responsibility in this mushrooming area of importance. The following is a quote from an FFIEC assessment issued in December 2014 that foreshadows the focus discussed here:

"Today's financial institutions are critically dependent on IT to conduct business operations. This dependence, coupled with increasing sector interconnectedness and rapidly evolving cyber threats, **reinforces the need for engagement by the board of directors and senior managemen**t, including understanding the institutions cybersecurity issues in meetings; monitoring and maintaining sufficient awareness of threats and vulnerabilities; establishing and maintaining a dynamic control environment; managing connections to third parties; and developing and testing business continuity and disaster recovery plans that incorporate cyber incident scenarios."

Note the key reference to the board of directors and senior management. Translation: The banker simply pointing to the IT person or the outsourced vendor to cover everything on this with examiners likely won't cut it anymore. YOU and/or your board made the decision for the bank to be on the Internet and it is a risky "place" and becoming riskier all the time. There is an expectation that BOTH senior management AND the BOARD understand the IT and cyber security issues in their institution and are kept informed. IT people /vendors should be able to easily and simply summarize the basic and most pertinent threats and issues for you without incomprehensible techno-jargon. Request that they do so very soon!

In coming editions, we will break down some keys things to be done by the bank in getting ready for examiners on this subject. As a preview, do you and your board know some basics, such as **the seven most common cyber threats/risks or the four core functions (also known as pillars) of a cybersecurity framework?**

Senior management and boards MUST devote the time NOW to becoming informed and IT people/Vendors must provide it to them – this can no longer be avoided.

April 1, 2015

Part 2:

2015 Bank Exam – One KEY Area of Focus from Federal Bank Examiners You May Not Expect (Part 2)

In Part 1, we noted the FFIEC IT and Cyber security report focus on senior management and the board of directors of community banks in being informed and involved in IT and cybersecurity for the bank and how this is expected to translate into more bank examiner focus and expectations for more understanding by senior management and boards of directors of the risks for the bank in coming exam cycles**. In the most recent review of common examination issues from the 10th Federal Reserve District, "IT" was the most cited issue (over credit risk, BSA, etc…)**. Not being ready on this will affect Management ratings. So we asked: "do you and your board know some basics, such as **the seven most common cyber threats/risks or the four core functions (also known as pillars) of a cybersecurity framework?"** Now for the answers (in summary form)….

The four core functions or pillars for a cybersecurity framework are:

1) Identification of risk — identify the internal and external cybersecurity risks to systems, assets, data, and capabilities;

2) Protection — protect business operations from damages or losses through policies, procedures and controls;

3) Detection — detect and identify the occurrence of a cybersecurity event through governance, monitoring and reporting;

4) Response and Recovery — respond to a detected cybersecurity event and recover and restore any capabilities or services that were impaired during the event among many others.

The seven cyberthreats: (1) malware, (2) distributed denial of service attacks, (3) automated clearinghouse/payment account takeover, (4) data leakage, (5) third-party/cloud vendor risks, (6) mobile and web application vulnerabilities, and (7) weaknesses in project management or change management.

Board and Bank Exam Preparation. We also alluded to some things the board and the bank can do to prepare for the exam, which we spell out here now in this Part 2, as follows:

• Board meeting minutes should begin to reflect these items of IT and cyber security risk being presented and discussed with board members on some regular basis (monthly at first then quarterly?);

- Senior management needs to at least understand some basics such as **the seven most common cyber threats/risks**, the parts of the bank threatened by each, the risks posed by these for the institution, the industry standards and **the four core functions (also known as pillars) of a cybersecurity framework** that the IT people/vendors are employing to protect the bank, have reviewed them with the board with this reflected in the minutes, and be able to discuss them on some level with examiners;
- Monitoring must be ongoing and records of that showing the bank's awareness of threats and vulnerabilities should be available for examiners, reported to the board regularly and meaningfully, and be reflected as such in the board minutes;
- Demonstrable efforts towards a "dynamic control environment" (keeping up with and changing the approach(es) timely in response to real world threats and changing technology, etc…) and senior management's understanding of what that means, as well as reporting to the Board regarding the progress for this on a regular basis (quarterly?);
- The business continuity and disaster recovery plan must incorporate cyber incident scenarios and like all plans and policies, be presented to and approved by the board;
- IT vendor service agreements and the bank's vendor management policy in connection with IT and cyber security;
- Adding insurance coverage for cyber breaches and understanding what is and what is NOT covered (all policies are not the same) and how to mitigate for the lack of coverage should be explored and reported to the board and reflected in the minutes; and
- Integrating the bank's particular cyber security framework with the bank's risk management and disaster recovery plan so senior management is necessarily informed to be able to make good and prompt decisions and follow a methodical, well thought out response in the midst of the crises.

Getting started with diligent pursuit of a better grasp of this will be a time and focus commitment for you, your staff and your board. It may seem like a hassle. But this is a hassle that's going to have to be undertaken no matter what. So avoiding the hassle now and not getting started will likely result in even more time and focus as a result of a less than favorable exam on the subject and the resulting greater hassle that brings. We don't want that. Best of success.

<u>April 15, 2015</u>

AOCI Opt-Out (yawn) – ***THE TIME IS <u>NOW</u> AND THIS IS THE <u>ONLY</u> OPPORTUNITY YOU WILL HAVE TO OPT-OUT!!!*** Is your board involved?

Accumulated other comprehensive income ("AOCI") Opt-Out is finally here! #itsfinallyOpt-Outtime. The "Opt-out" means to elect in the bank's 3/31/15 Call Report to option out of certain changes brought by BASEL III capital rules requiring the treatment of unrealized gains and losses as includable in regulatory capital. For most community banks, the "opt-out" maintains as much as possible the 'status quo' for community banks in this regard.

This is a simple reminder and we know for most it isn't necessary. But *just in case* someone needs a reminder for any reason, well, **<u>IT'S FINALLY TIME – NOW - TO TAKE ACTION, AND TIME IS RUNNING OUT</u>**!!! And, if you haven't already determined what you are doing on this, grab your bank regulatory accountant, securities investment adviser, or trusted adviser and get a meeting (conference call probably is ok) set with your board **<u>before April 30</u>** (or whenever before then you are filing your 3/31/15 Bank Call Report), and get it figured out and make your election in your Call Report filing. Then document that in the board minutes. And let's not do all of this and fail to actually make the correct election where it matters, in the Call Report (hey, we've all clicked on the wrong thing and this is a one-time only election): Here is an excerpt from the FFIEC's Instructions for this in Schedule RC-R [whomever is actually filing for the bank MUST confirm this from the instructions themselves]:

"An institution that makes an AOCI opt-out election must enter "1" for "Yes" in item 3.a…."

"…An institution that does <u>not</u> make an AOCI opt-out election … enters "0" for "No" in item 3.a…."

So Opt-out = "1" for "yes" on the Call Report. Simple as that! <u>IF</u> that's what your bank has decided to do.

This does not require under regulatory law any board action (a resolution, vote, etc… of the board of directors), but it would be wise to at least discuss the option with the board and reflect this in the minutes. Consider though, there are long term and varying economic conditions that play into this decision. So, at some point in the future when rate and other economic conditions have dramatically changed, do you really want to be the banking officer who didn't consult your board on this and made what in early 2015 looked like an obvious and easy decision without the board, that turns out to be short-sighted under different conditions?? Short-sighted decisions and their unsavory outcomes seem to be far more bearable in groups than alone. (If Socrates didn't say that, he should have.)

Oh, **<u>and if your bank is opting out, then you also have to Opt-Out for your Holding company in its next FR Y-9 filing</u>**. And vice versa, if your bank does not opt-out, then your holding company must do likewise in its next regulatory FR Y-9 filing. Remember, choose wisely as it is final: There will be no opportunity to change the AOCI methodology in future periods.

<u>April 29, 2015</u>

Reg B, Marital Status and Jedi Mind Tricks: Not merely a "consumer" law and Affirmative Intent Required

Ever had to send a letter to a customer saying your bank violated the law in the loan with the bank, return an original executed document (Note or Guaranty) to the customer marked "void," and inform them they may have a right to sue the bank over the matter? Some have, and there's no reason for you to be next. What's unsettling, is how easy it is for it to happen even though you know better than to assume a spouse is going to co-sign or guaranty their spouses' debt, so you and your people are well trained. Spouses guarantee each other's debts all the time. It is common. But does your commercial or agricultural loan file actually show that guaranty is legal or not? Does your loan file actually reflect that it was their intent to apply for the credit jointly or to serve as a guarantor? Their signature on the guaranty does NOT accomplish this. And the thing is, the very thing in their file many bankers think shows joint intent, is legally declared not to show joint intent. Read on.

Many community banks do not have commercial or agricultural loan application forms. Instead, they take financial statements and tax returns along with corporate/LLC documentation and the like. If there is no application at all the documentation may (and often does) not adequately support a joint application. Invariably, the banker points to the joint financial statement signed by both spouses. However, even if signed and dated concurrently with the loan application by both spouses, a joint financial statement is NOT determinative of joint intent to apply for the credit. Burn that last sentence into your brain. You have to have more than that documented in your loan file and yes, not just on consumer loans, even your commercial and agricultural loans. You really need to have an affirmative statement of intent by the spouse, such as is typically included in most consumer loan applications, a “check the box” concurrent statement of intent with the principal loan applicant, if you will, along with the spouse’s signature and date on the application indicating the intent to jointly apply for the credit.

Otherwise, your file may not clearly reflect that intent and despite your best Jedi Mind Tricks, without affirmative evidence of intent to jointly apply from the spouse actually in the file, your compliance regulator can end up with no option but to require you to notify the customers in writing that the bank violated their rights, sending them their original documents back and advising them they may have other rights to pursue against the bank for violating their rights. THEN, the regulator could also have no choice but to refer the matter out to DOJ, and your community bank could be facing the US Dept. of Justice (DOJ) for spousal discrimination, a very serious, unhappy and expensive proposition to face at the same time as the rest of what we’ve described is unfolding. Further, they may then investigate and find other evidence of other types of discrimination if they choose to do so.

Consider some sort of loan application form even for your commercial and agricultural credits that includes an affirmative statement of intent to apply for joint credit, and make sure it is completed, signed and in your loan file where it is called for so your bank is not unnecessarily at risk. If you’ve arrived at a different solution than this that has worked well and withstood testing, that’s terrific, we applaud you.

May 13, 2015

Clowns to the Left - <u>Competing Claims to Deposits - Bank in the Middle</u> - Jokers to the Right…

Scenarios where a bank account is claimed by multiple people not on the account don’t have to be so scary for bankers: Not as scary as clowns are to some of us, anyway. To summarize, absent a court order, trust or indemnity bond given to the bank, the bank is really only required to determine what its own deposit account records say about whose deposit it is and then honor that. Let’s dig in a bit to understand a little better.

So, for example, Offspring 1 (a well-known local “less than good guy”) was added to the standard deposit account of Mr. & Ms. Depositor before the Mr. passed away, and the account is now and has always been marked as a Joint Tenancy and is not a POD (payable on death). Now Offspring 2 (sterling daughter from out of town) shows up to “help” the Ms. and is telling the bank horror stories (believable) about Offspring 1 and is demanding (perhaps with a very threatening attorneys demand letter) the bank not pay out to Offspring 1 any of the funds from the account and if you do, you’re going to be liable for any funds paid out because she’s given you “notice” of Offspring 1’s heinous conduct. But unless Offspring 2 obtained a court order to that effect, or can show the funds are in trust for them, or provides an indemnity bond to the bank (if you accept it), the only question is, who appears as the account party on the bank’s records? And whoever that is, the bank may deal with them in good faith on the account in their name notwithstanding the noisy demands of Offspring 2.

Here is Oklahoma’s deposit law statute governing this **<u>which is applicable to both State and National Banks</u>**: http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=76934

Note: In this scenario above, we can take up another time if the bank may have a legal obligation to notify DHS Adult Protective Services and what that might mean for the Bank. Also, keep in mind, these situations can certainly get very complicated and facts that are unique or outside of the assumptions in the statute and this Update, or that invoke other laws, may cause a different result than depicted here.

May 28, 2015

Q: Can a director (or other management official) serve as a director of two different banks in the same market?

Law: This doesn't come up a lot, but when it does it is usually important. This issue is specifically addressed in the law and is known as Management Interlocks. The Federal Interlocks Act and the federal regulations generally "prohibit a management official from serving two nonaffiliated depository institutions, depository institution holding companies, or any combination thereof, in situations where the management interlock would likely have an anticompetitive effect." Quote from the Federal Reserve's Regulation L. For national banks, see 12 CFR 26. And for non-Fed Member Banks, see 12 CFR 348.

A: It is often actually permissible in the case of community banks the size and circumstances we have in Oklahoma. For example, if the other bank is simply not in same community or MSA. But even if it is, they could fall under the small market share exemption (the 2 banks together control not more than 20% of deposits in the community or MSA). There are other exemptions, too. One is even simply at the discretion of the primary federal regulator as to whether it is anticompetitive. The bottom line, is that while it may be prohibited, it should not be assumed it would be prohibited because many community banks in Oklahoma are likely to fit at least one of the exemptions. It is certainly worth looking into if the matter comes up.

Note: Confidentiality, privacy, competitive conflicts between banks, and conflicts of interest and how those are to be dealt with should be discussed and policy set that protects customers, bank, other board members.

June 10, 2015

Change in control – Part 1. **A common misconception amongst bankers, is that a bank or holding company has no responsibility in this if shareholders are trading shares that trigger change in control but don't pursue the proper change in control filings.** How do the shareholders get their shares registered on the shareholder ledger of the bank or holding company? They turn in their old certificates for issuance of new certificate(s) by the bank or holding company because that's who's in charge of the stock ledger and certificates. So you can see, the bank or holding company certainly does have responsibility to monitor and catch this when it becomes aware of changes in shares of its own stock.

Sometimes also referred to as a change **of** control, these are "transaction based" and can be sneaky areas of non-compliance that come up any time changes occur in ownership of bank or holding company stock even small amounts of stock. It is obvious when someone who has not been in control before is acquiring all or a majority of the shares, that they are changing control. But non-compliance with change in control laws usually occurs because of a transaction involving bank or holding company stock that seems innocuous. **Each person and/or group who has the legal right or power to control shares that add up to 25% (in some cases this may be 10%) of shares, MUST provide NOTICE and be approved to be in that position.**

Federal change in control laws (discussed above) apply to all banks and Oklahoma change in control laws apply to Oklahoma chartered banks. For Oklahoma chartered banks, Oklahoma law requires that notice for a shareholder of an Oklahoma banking organization who becomes or has contracted to become vested with 10% or more will be required to be provided to the Oklahoma State Banking

Department regardless of what may or may not be required by Federal change in control law. **And the president or other chief executive officer of the Oklahoma chartered bank or bank holding company is legally responsible by statute to report any such change of a bank or bank holding company, immediately upon obtaining knowledge of such change in the control or contemplated transaction involving a change in control (of 10% or more of stock).**

Banking organizations cannot turn a blind eye to shareholders exceeding change in control limits without providing federal and state regulators the timely notices required by law.

Next time, we'll cover particular provisions of law for change in control requirements to help you understand "control" better, identify when filings may be required, and cover some common situations that give rise to change in control compliance issues.

June 24, 2015

Change in Control - Part 2. In Part 1 we covered some basics on change in control (sometimes referred to as "change of control") of banks and holding companies and established that not only do the individual shareholders have responsibility to file for change in control**, so does the banking organization have responsibility as well**. This is not advice, but a general caution: a **bank officer who is keeping the bank or holding company stock ledger and issuing stock certificates ordinarily should not allow shares of stock to be transferred** on the bank's or bank holding company's ledger and permit issuance of stock certificate(s) by the bank or bank holding company to anyone, unless and until the bank officer is reasonably sure that no change in control is involved or that an appropriate notice has been successfully processed for the shareholder to be. The bank's share ledger (and not necessarily who holds the share certificate(s)) is legally the record of who owns or controls the shares and the bank officer(s) charged with such duties by the bylaws, board resolution &/or in practice, is expected legally and by regulators, to properly fulfill that function without allowing violations. This (along with numerous other reasons) means bank or holding company officers charged with this duty should be trained in this duty or it reflects poorly on management.

So what are some examples of change in control situations that can take a bank officer by surprise? There are many ways this can come up, here are just a few.

In recent times, estate planning is a common culprit. A banker decides to do some estate planning and the estate planner is not versed in bank control law. The banker holds their shares in just their name and not jointly with their spouse so that their spouse has never been approved as a control person. A-B (living) trusts are created (or other types of trusts) and the shares are placed in the trust(s). The problem is that the A-B trusts typically have both spouses as co-trustees (each spouse is a co-trustee on the trust of the other spouse), which means as soon as those shares are placed in the banker's trust, the (previously unapproved for control) spouse has the power as a co-trustee to vote all of those shares in the trust (even if they don't actually vote them), so at that point, the banker's spouse legally controls those shares as a trustee and likely a violation of change in control law has occurred. There may be other issues with the trust depending on what other assets it holds. Sometimes simple solutions are available that don't at all interfere with estate planning goals and methods especially if included from the beginning, but even after the initial estate planning work is done and violations occurred, these solutions may be workable. There are numerous and more complex examples of this and other less obvious situations, but this conveys the idea.

Simply put, if it involves an approved control person transferring any (regardless of number of) shares to anyone including a trust /trustee who has not been approved even if it is family, there is a possible change in control violation that may occur depending on the details.

Another common situation that surprises bankers sometimes, is the case of a stock redemption (by the bank or holding company) with one or more shareholders where the shares aren't simply immediately issued out to other shareholders but are retired or taken into treasury. The other shareholders continue to hold their same number of shares, only the redeemed shareholder's share numbers are affected and none of the remaining shareholders has transferred anything, so no one has changed control have they? But they may have because "change in control" is legally all about percentages, i.e., who owns, holds or controls 25% or 10% of the outstanding voting stock and we just changed the denominator of the percentage calculation. So when a stock redemption occurs, the number of shares outstanding (the denominator) is reduced, resulting in the remaining shareholders still holding their same number of shares (the numerator), but those shares now make up a higher percentage of the now smaller total number of outstanding shares (the denominator), which may cause the remaining shareholders to exceed the legal percentage of 25% or 10% where they never had before. For example, if there were 100 shares outstanding and you owned 23 shares before retiring employee's redemption of their 9 shares, there are now only 91 shares outstanding after the 9 redeemed shares are removed and so now you own 23/91 or 25.27% -- oops! You're at or over 25% and a change in control has occurred and if it and you weren't previously approved, a violation of law has occurred. We can call it a back door change in control. Further, the bank or holding company was clearly involved in it since the shares were redeemed, and has a responsibility to insure control of its stock is properly approved before allowing the transfer on the banks share ledger.

Having given you in this Note an idea of what "control" means (hold, own and/or power to vote stock) and some common and perhaps surprising situations that can arise to "change" it (trusts, small share transfers and back door), we'll continue from time to time in future Notes to cover various topics of interest and common violations, including those pesky percentages (usually equal to or greater than either 25% or 10%, but….), when filings may be required (pre/post transfer by how many days…?), specific legal citations (for the compliance nerds), change in control filing tips, and some other change in control compliance and training considerations.

July 8, 2015

Bank Compliance with Federal Civil Court Subpoenas for Documents or Records

What if your bank receives a civil subpoena for documents or records from a Federal Court in New York in case in which your bank is not a party? You know you should not send the customer (or former customer) records out if the subpoena isn't even valid or enforceable in the first place, that can get you sued. So, do you have to comply with that long distance, non-party subpoena? After all, your bank has no ties to New York, is not even in the case, so that Court has no jurisdiction over your bank and its records – or does it?

Beginning at the end of 2013, the federal rule governing civil subpoenas (FRCP 45) simplified subpoena practice (somewhat) which, in turn, simplified (somewhat) the rules a banker has to keep in mind when determining whether the federal civil subpoena for financial records should be complied with or should not be complied with.

When a banker receives a civil subpoena, the first question to ask is "out of which court did the subpoena issue?" If the answer is a federal (United States) District Court, then the amended FRCP

45 procedure allows for subpoenas to be issued from the court where the action is pending and can be lawfully served and enforced nationwide.

There is still protection for subpoena recipients in the geographic limits for compliance with the subpoena. If an Oklahoma bank receives a subpoena for financial records from a case pending, for example, in a United States District Court in New York, that subpoena can issue from that distant federal court to you, a bank in Oklahoma. HOWEVER, the place for delivery of the financial records is required to be within 100 miles of the location where the subpoenaed bank is. The place of production must be "within 100 miles of where the (bank) resides, is employed, or regularly transacts business in person". So if the place of compliance with the subpoena is within 100 miles of a branch of the bank, there is a meeting of the geographic requirements of FRCP 45.

If the place of compliance is not within 100 miles of any bank office no matter how you look at it, what should you do? Don't just produce the documents. Pick up the phone (or have your bank's attorney do so) and call the subpoenaing attorney to discuss the issue. After all, they just want their documents and you just want to comply legally and get it over with. He/she can find a place to receive the production documents within the 100 mile range of your bank. "Why bother? It is just as easy to produce within 100 miles as it is outside of 100 miles!" you may think. The reason to bother is to keep the bank from being at risk from a customer damaged because his/her/its records were sent out of the bank to people who are not the customer without the cover of jurisdictionally sufficient subpoena. You may think—"The bank is covered by the subpoena—I would not have sent out the records without a subpoena!" But if the subpoena is not valid and enforceable as it is, or if it is truly defective, then the bank is at risk when sending out customer records without proper authority to do so.

Another important protection in FRCP 45 is that the subpoenaed bank does not have to go all the way to the court where the action is pending to object to a subpoena, i.e., New York in our example. The FRCP 45 provides that the United States (federal) District Court where compliance is required is the forum for resolving subpoena issues. Which as noted above, is required to be within 100 miles of the bank. So, if there are issues which need to be resolved legally, the bank can locally address those issues with its regular attorney, rather than having to hire distant counsel to represent its interests in a distant forum.

July 22, 2015

In case you missed it or didn't get a chance to review, the federal bank regulatory agencies recently issued their new and improved, Compliance Examination Procedures for Truth in Lending Act (Regulation Z) and Real Estate Settlement Procedures Act (Regulation X) Mortgage Rules. Obviously since these are many pages they are too extensive and detailed to fully address or even summarize in a brief update. However, it is suggested that community banks consider using these like a reference manual for developing, drafting, reviewing, revising and implementing policies and procedures in your bank or for compliance audits/reviews or regulatory exams. (See links below to these lengthy documents.) But first, a brief example of the manual in an area of concern for community banks (at least its brief compared to the new exam manuals).

There seems to continue to be uncertainty or some lack of understanding and knowledge on the topic of delinquent home mortgage servicing, foreclosure limitations and related requirements as a result of recent changes in the law. e.g., "can we contact our delinquent borrower, how, when and how often can we contact them regarding their delinquency, can we present options for addressing it and consequences for not addressing it, what if we miss a time frame, etc…." Some don't seem to be truly aware of the 120+ day prohibition on submitting the delinquency to foreclosure or the 37 days before foreclosure requirements, and those who are aware may not be aware of the particulars or what does and does not apply to their institution or a particular mortgage loan and why. Every bank should have clear and specific policies and procedures on these matters. They are not hard, but they MUST be done and carefully followed. Here is a reproduction from the new Federal Exam Manual of only some selected portions pertaining to this topic:

Prohibitions on Commencing Foreclosure Proceedings and Dual Tracking

Complete the following for any borrower.

1. Determine whether the institution made any first judicial or non-judicial foreclosure notices or filings before the borrower was more than 120 days delinquent (12 CFR 1024.41(f)(1)). (Note that this requirement as applicable to small servicers is addressed below.)

2. For any complete loss mitigation applications received by the institution either within the first 120 days of delinquency or before the institution made the first judicial or nonjudicial foreclosure notice or filing, determine whether the institution made the first foreclosure notice or filing only after one of the following occurred: (i) the institution notified the borrower that it had denied the loss mitigation application for any loss mitigation option and if an appeal is available, either the appeal period expired or the appeal had been denied; (ii) the borrower rejected all the offered loss mitigation options; or (iii) the borrower failed to perform under a loss mitigation agreement (12 CFR 1024.41(f)(2)).

3. If the institution received a complete loss mitigation application after the institution initiated foreclosure but more than 37 days before a foreclosure sale, determine whether the institution improperly conducted a foreclosure sale or moved for foreclosure judgment or sale before one of the following occurred: (i) the institution notified the borrower that it had denied the loss mitigation application for any loss mitigation option and if an appeal is available, either the appeal period had expired or the appeal had been denied; (ii) the borrower rejected all the offered loss mitigation options; or (iii) the borrower fails to perform under a loss mitigation agreement (12 CFR 1024.41(g)).

In future Updates, we'll cover the consequences of violations of provisions like these 120+ and 37 day prohibitions.

Here are the promised Federal Agency Exam Manual references:

FDIC: RESPA - https://www.fdic.gov/regulations/compliance/manual/5/V-3.1.pdf &

TILA - https://www.fdic.gov/regulations/compliance/manual/5/V-1.1.pdf

FED: RESPA - http://www.federalreserve.gov/bankinforeg/caletters/ca1503a2.pdf &

TILA - http://www.federalreserve.gov/bankinforeg/caletters/ca1503a1.pdf

OCC: RESPA - http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/interagency-RESPA-procedures.pdf

TILA - http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/interagency-TILA-procedures.pdf

August 5, 2015

CBAO Weekly Compliance Update - EGRPRA - Proposed Regulatory Changes

A Federal law known as the Federal Economic Growth and Regulatory Paperwork Reduction Act of 1996 (“EGRPRA”), requires the federal bank regulatory agencies, along with the FFIEC, to conduct a review at least every 10 years to identify outdated or otherwise unnecessary regulations. Last year the agencies began the process again. Following the ICBA’s September 2, 2014 comment letter noting previous EGRPRA results were at best disappointing and suggesting regulators conduct outreach meetings around the country for community banker input, the Federal banking agencies (sans CFPB) although not required to do so, organized regional outreaches across the country to their banking constituency and the public for input on the process. The Federal Reserve Bank of Kansas City hosted this event in our area yesterday 8/4/15. **This was the only one of these events that included an emphasis on rural community bank issues.** Esther George and her staff did a terrific job of hosting the event at their facility in Kansas City and it was well attended.

The bankers were all well prepared and gave good, specific and detailed critiques, information and suggestions for regulatory changes. Antlers, Oklahoma, banker David Burrage served as a panelist and well represented the state. It was encouraging because Comptroller Curry, Vice Chairman Hoenig from the FDIC, and Michael Gibson, the Director of the Division of Banking Supervision and Regulation with the FED Board of Governors, along with state regulators among others, were present and actually seated on the stage under full view by a room full of bankers and bankers association representatives as they were directly confronted by the bankers and other panelists who had been invited to participate. We observed several of them taking notes throughout the presentations and they asked some questions of the bankers. One banker panelist explained the regulatory situation at the beginning of the day with the phrase “death by a thousand cuts,” as descriptive of what community banks are experiencing. Several of the suggested solutions to specific regulations responsible for those “ thousand cuts” that would afford relief are summarized, as follows:

BSA

- Increase CTR from $10,000 to a higher amount ($20-25,000 most commonly suggested as giving reasonable relief, 60-70% reduction in CTRs, and updates the number accurately for inflation from when originally introduced); and

- Simplify to realistically reflect a bank’s true BSA risk using the bank’s history.

CRA

- Retool CRA measurements to give credit for meaningful community contributions of funds, time, resources, etc., that fit the rural community bank model.

HMDA

- Exemption for banks with minimal number/dollar amount of loans in MSA;
- Do not implement the next proposed increase of data points to include in LAR; and
- Return MSAs to rational size/areas instead of extending them to cover essentially rural or non-metro areas.

Reg O

- Increase $1,000 overdraft limit to a higher amount, such as $2,000 - $5,000; and
- Increase $100,000 Exec Officer limit to $500,000.

FDICIA

- Audit trigger for bank size should be increased from $1B to $2B.

Call Reports and Exams (for well capitalized and CAMELS 1 or 2 banks):

- Q2 and Q4 would be full Call Reports, with Q1 and Q3 simplified or "short form" Call Reports (originally suggested by ICBA); and
- RC-R page(s) simplified for non-complex community banks;
- No on-site exams during Call Reports preparation time;
- Increase threshold from $500M to $1B or $2B, non-complex banks, for 18 mo exam cycle; and
- For non-complex banks, unless Call Report or other circumstances indicates a need, push exams to 24 month cycle.

QM & ATR

- Exemption for bank under certain size as to all mortgages on its books.

APPRAISALS

- The trigger for appraisal on real estate loans needs to increase from $250,000 to $500,000 (or more); and
- Exemption for banks under a certain size to allow banks to do their own appraisal/valuation on residential mortgage loans for mortgages to be held on its books.

All of the dollar amounts above would also be inflation indexed (possibly cpi) going forward.

In the last panel of the day after a great foundation had been laid by the earlier presenting community banker panelists, Deron Burr, banker from the small rural town of Seneca, MO, concluded his excellent and very engaging presentation (by which he clearly had the attention of the key people there), with this: "The trend of fewer and fewer community banks in America must change: the fabric of our country depends on it."
The regulations under review are: http://egrpra.ffiec.gov/federal-register-notices/fedreg-index.html

The comment periods for submitting written comments (some have expired but some are still open or will be open) are set out here: http://egrpra.ffiec.gov/federal-register-notices/fedreg-index.html

August 20, 2015

CBAO Weekly Compliance Update - Shockwave

Welcome to the brave new world of bank regulation. As some predicted would happen, the CFPB has begun (some would say continued) to cull areas not so well trodden by bank regulators not long ago and by using newly fashioned laws like Dodd-Frank to impose unprecedented liabilities and penalties on banks for commonly accepted practices. And they found such an area in Citizens Bank, N.A., formerly known as RBS Citizens Bank, N.A.; Citizens Financial Group, Inc., formerly known as RBS Citizens Financial Group, Inc.; and Citizens Bank of Pennsylvania (collectively "the bank"). The bank had heinously dared to require that its customers take responsibility for making sure their deposits were accurate below a de minimus level ($25-$50). The bank simply scanned in the deposit slips and didn't bother to check the actual deposits if there was a discrepancy below that threshold. The official subtitle to the press release from CFPB was: ***CFPB, OCC, and FDIC Take Action Against Bank For Ignoring Deposit Discrepancies***

So CFPB determined this conduct of not redoing their customers math even on the smallest of deposits, to be a violation of: drum roll…. ***UDAP***. (Section 5 of the Federal Trade Commission Act.)

No surprise there. The breathtaking reasoning in applying UDAP as a legal basis, was in part that the bank's deposit agreement documentation which stated that deposits were "subject to verification," or words of such import, and so they essentially ruled that this provision *implied* "that the bank would take steps to ensure consumers were credited with the correct deposit amount," so the bank's failure to do so and leave the responsibility for deposits with the customer constituted an unfair or deceptive practice. A chilling and very strained line of reasoning that makes sense to them, especially when you consider how this type of reasoning can be applied in multiple areas of bank operations.

Now, let's assume the bank has been examined on either a 12 or 18 month cycle. But these declared violations go back to 1/1/2008. So the bank had been examined by its primary federal regulator for safety and soundness and compliance several times over for 7 years apparently without a material issue with this, or the press releases and reports would have mentioned it. Various numbers have been floated around, but the official agency totals from the reports we saw are:

	CFPB	**FDIC**	**OCC**
Refund:	$11MM	$5.8MM	$-0-
CMPenalty:	$ 7.5MM	$3MM	$10MM

You can finish the math on that. So after several safety and soundness and compliance exams presumably not bringing this up, suddenly it is so serious that these types of measures are required? Not enough was made in the media and banking circles the last week of the "violation" hat being hung partly on the innocuous provision in the account agreement of deposits being "subject to verification." It seems to be the lynch pin for the determination of a violation. The official versions don't seem to indicate if only deposits that were in favor of the bank were ignored but the others were not, which if that's the case, that would be an indicator of some malevolent intent, so you'd expect it to have been clearly stated if that were the case.

But here's the kicker: This came from an employee whistleblower who turned in the bank for this practice, which as you likely know, has been a commonly accepted practice in the industry. And, it turns out that under Dodd-Frank, the regulators are actually required to "… pay an award or awards to one or more whistleblowers who voluntarily provided original information… that led to the successful enforcement of the covered judicial or administrative action." The amount to be paid is between 10 and 30 percent of the monetary sanctions imposed. You can finish the math up on that as well.

What's next, the failure to carefully review every signature on every check, POS, etc., now constitutes deceptive practices?

Welcome to the brave new world of bank regulation.

September 2, 2015

This is a "compliance" note update that applies to ALL loans involving an Oklahoma mortgage, whether commercial, agricultural, or consumer.

As of November 1, 2015, banks and other mortgage lenders holding a mortgage on Oklahoma real estate will have only 30 days from the payoff of the mortgage debt to record a Release of Mortgage vs. the 50 days that has been the standard for decades. If not released within the 30 days, the borrower (actually, the mortgagor who mortgaged the real estate whether or not that is the same as the borrower) may request the release in writing and the mortgage holder must release the mortgage within 10 days of the request or face statutory damages (1% of the principal debt per day up to $100 per day accruing up to the total principal amount of the debt, until the mortgage is released). The penalty is enforceable in court by the mortgagor against the lender. This is the same penalty that has been around for decades. This author has seen a number of these situations occur in which the full principal note amount accrued as a penalty and even more situations in which substantial but less than the full principal debt accrued as a penalty, even under the old 50 day release period. The penalty if ultimately awarded, continues to accrue even during the litigation until a release is filed of record or the penalty reaches 100% of principal. Interest also accrues on the judicially awarded penalty amount. Generally, neither party can recover attorney fees in these cases. The statute of limitations for the mortgagor to file a lawsuit vs. the lender to enforce this penalty in court is 1 year from when the mortgagor makes the request to release in writing to the mortgage holder.

The statute only imposes the penalty on the “holder” of the mortgage. So mortgages originated and sold by an Oklahoma lender into the secondary market or otherwise sold to another party with a valid and properly recorded mortgage assignment (that have not been turned back to or repurchased by the originating lender for some reason) would not for the originating lender, appear to carry any responsibility to release or liability for this statutory penalty.

Interestingly, another change in the statute effective Nov. 1, allows a title insurance company to enforce the penalty in court on behalf of the mortgagor. However, it only authorizes the title insurer to bring the lawsuit to enforce the penalty once it has begun to accrue. It does not however, expressly authorize the title insurance company to make the initial written request for the release on behalf of the borrower. It is not yet known for sure whether a written request by a title insurance company on behalf of a mortgagor would be honored by a court as effective to start the time for the penalty to begin accruing against the lender. But ignoring such a request would not seem advisable under ordinary circumstances.

An occasional question regarding UCC fixture filings and whether this statute applies to these filings arises. The answer is that this statute does NOT apply to UCC fixture filings according to Oklahoma case law interpreting the statute. Nothing about the Nov. 1 changes would appear to affect this.

The statute referenced above is 46 O.S. Supp. 2015 §15 and can be viewed in full here:
http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=72042 .

September 16, 2015

The CBAO Annual Convention concluded last Friday morning with the bank regulators panel followed by Oklahoma’s Attorney General Pruitt. The panel consisted of:

- **Oklahoma** Deputy Bank Commissioner, **Dudley Gilbert**;
- **Federal Reserve** Bank of Kansas City Vice President of Department of Examinations and Inspections, **Jim Hunter**;
- Deputy Comptroller of the Southern District, **Office of the Comptroller of the Currency**, **Gil Barker**; and
- **FDIC** Dallas Regional Director, **Kristi Elmquist**.

In addition to their helpful hints as to what to expect in coming exams and current issues, it was good to hear our local bank regulators overtly express their various points of view on certain regulatory burden reduction matters. The following in no way will cover the many important matters addressed by the various panel members, but we do want to highlight a few helpful items for this week's compliance note.

Oklahoma's Deputy Bank Commissioner Dudley Gilbert stated that the Department is endeavoring to do more of their exams off-site. Commissioner Thompson began this approach promptly after he became Commissioner in 1992 and has continued to press for more common sense off-site examining to occur when feasible. The recent area of emphasis is off-site loan review, which is possible for banks that have their loan files imaged AND well organized. Deputy Commissioner Gilbert noted that approximately 50% of the state banks have imaged their files. He also pointed out that the Department has reduced assessments and plans to continue to propose it for this coming year as well. Due to the potential risks from the drop in oil prices, Deputy Commissioner Gilbert stated that the Department has added an Oil & Gas work program which entails a questionnaire. This questionnaire will be sent to banks within particular geographical areas involving oil & gas activity (due to location, not because they suspect particular issues with the bank), so it is possible that a bank that has no oil & gas involvement but is within the target geographical zone could receive an Oil & Gas questionnaire. There is no other intended purpose so if the questions are inapplicable, the bank should simply so indicate.

Jim Hunter of the Federal Reserve Bank of Kansas City mentioned four areas of emerging risk: commercial real estate, energy, agriculture and cyber-security. He mentioned their 2015 telephone survey of selected banks in particular geographical areas involving oil & gas activity to determine the effects of fluctuating oil prices on those banks. So far the effects have not been of any great concern, but it still bears some attention as the lower prices continue. He also noted that in his view, keying the loan loss to actual risk rather than using a GAAP analysis would probably be far more helpful to bankers and regulators. He also indicated that for community banks the Basel III requirements could be simplified and streamlined.

OCC Deputy Comptroller Gil Barker emphasized changing the real estate appraisal regulations. He indicated that a more rationally based set of standards or requirements would assist banks in acquiring better appraisals in a more timely fashion. He also made the point that as to many of the regulatory changes that are not statutory, the OCC is not waiting on the EGRPRA process (which will take another couple of years) to take steps to address the needed changes. This point was also echoed by the other federal regulators.

FDIC's Dallas Regional Director Kristi Elmquist mentioned these areas of emerging risk: oil prices, interest rate risk, and cyber-security. She showed a slide indicating a great number of counties in Oklahoma with more than twice the oil-related employment concentration than the U.S. and another that identified Oklahoma as one of the five riskiest states to experience home price declines in the next two years. She noted that the threat of cyber security breaches is growing rapidly and that the FDIC has compliance worksheets on the FDIC website to help the banks address the risks. If you are an FDIC regulated bank, you can contact your case manager to access these and other tools for reviewing the sufficiency of various compliance areas. The other regulators noted the growing cyber security risk as well.

Lastly, they all agreed that banks participation in the EGRPRA process (like CBAO did in the August Outreach at the Kansas City Federal Reserve Bank), and continuing to provide regulators with specific examples of how regulations are burdensome for the banks and for their customers, will help. They say there is much more attention to regulatory reform amongst the regulators in Washington than previously, that there are many regulations that can be bettered without Congressional action, and their agencies are moving forward to do so.

As an Association, the importance of being an active voice for the reduction of the regulatory/compliance burden is more important than ever. Your active participation in the efforts of CBAO can make a difference and is encouraged.

October 1, 2015

TRID (TILA-RESPA Integrated Disclosure) is here, finally, in just a few days after all the (welcome) delays. Are you ready? **October 3, 2015 is the effective date** as you well know. What if you are not ready, or just not comfortable that you're ready? What if there is a glitch with your forms software and it's not right, not reliable, or just not working? The CFPB announced that entities that have "*squarely focused on making good-faith efforts to come into compliance with the Rule on time*" will face regulators who are "*sensitive to the progress made by those entities*." The so-called "Sensitive Enforcement." But does this include something you know or suspect isn't correct? What types of efforts will they consider to be good-faith? And how does this protect your bank from potential liability to individual borrowers, upstream purchasers (assignees), or class action litigants.

To be clear, that statement and assurance of sensitive enforcement by the CFPB, **provides your bank no protection from potential civil liability for non-compliance**. Not all parts of TRID afford a private right of action against the bank. But there are enough that do provide private rights of action along with a host of newly created sources for private civil liability, that a full caution alert should be sounded if there is anything you are not comfortable is fully correct and compliant, whatever the cause. The whole idea of TRID is to make the creditor fully responsible for compliance with TRID. Compliance failure in this area could be devastating.

Make sure you are TRID-right before moving ahead with handling covered loans, i.e., most closed-end consumer mortgage loans. There is great and serious risk otherwise.

Best of success with TRID.

October 19, 2015

Bankers know they have the legal burden to **not** disclose the existence of **SARs** that their bank prepares and files. Most bankers know how to maintain the confidentiality of the SAR under normal circumstances, but what if a bank/banker receives legal process (a subpoena, discovery request, questions asked of the banker who is a witness in a matter, etc.…), or some other request for a SAR or for information included in a SAR? **At no point in any legal proceeding may a banker disclose the existence of the SAR or that one was filed by the bank**.

There are specific instructions in the law for bankers and their attorneys receiving legal process (subpoenas, discovery requests, questions asked as a witness in a matter, etc.…), among them being that bankers are the ultimate guardians of the SAR and these types of legal proceedings are NOT exceptions to the prohibition against disclosing the SAR. **Unfortunately, government prosecutors and even bank litigation attorneys are not always well versed on the limitations on the banker testifying and potential penalties for disclosure.** Even if the prosecutor or the bank's own litigation attorney is the one who asks the question in a proceeding (even a deposition or an affidavit), the banker must not disclose the SAR. The underlying information used to prepare or that supports the SAR may be disclosed, but not the SAR itself.

Any bank subpoenaed or otherwise requested to disclose a SAR or the information contained in a SAR shall decline to produce the SAR or to provide any information **that would disclose that a SAR has been prepared or filed**. Each regulatory agency has in its regulations identification of who to contact in the event a SAR or SAR information is subpoenaed or requested. The bank or bank's legal counsel assisting with the SAR (who is legally permitted to be informed of the existence of the SAR) should initiate this notice promptly. Anytime a banker will be testifying in a legal proceeding, deposition or the like concerning a matter that may give rise to circumstances in which a SAR is involved in some way, the banker should be fully prepared by knowledgeable and experienced legal counsel to insure SAR confidentiality and the banker are well protected.

A "real life" criminal case has highlighted the practical aspects of this. A case in point regarding nondisclosure is an instance where a bank filed a SAR and the end result was a criminal trial in U.S. Federal Court with the filing banker called as a witness. Government prosecutors (federal or state) are not always well versed in on the extreme limitations and risk on the banker concerning SAR disclosure, so they must be educated in this. In this case, the bank's regulatory attorney made certain both the banker and prosecutor were fully versed on both the financial confidentiality laws and SAR disclosure limits governing the banker, emphasizing that any questions related to the genesis of the matter (i.e., the preparation, filing, or existence of the SAR) would not be answered by the banker. The banker was carefully prepared with this section of the SAR regulations for any possible questions from the criminal Defendant's attorney on cross examination. The well prepared banker performed flawlessly.

SAR Non-disclosure (confidentiality) regulations are found as follow:

- National Banks: 12 CFR §21.11(k)
- State Member Banks: 12 CFR § 208.62(j)
- State non-Member Banks: 12 CFR § 353.3(g)

October 28, 2015

We all have expressed and continue to express our heartfelt thoughts and prayers for those affected by the horrifying events in Stillwater at OSU's Homecoming Parade this past Saturday. Sincere words and even the most heroic of deeds (of which there were many) can never fully or adequately express our deep feelings in the wake of such events.

Statutory Support Trusts. In addition to the emotional effects, community bankers are very often met with the very "real life" financial or economic effects of tragedy. In the same year (1995) as another Oklahoma tragedy, the Murrah building bombing in Oklahoma City, the Oklahoma legislature passed a law providing for the formation of a "simple" trust allowing accounts to be opened by persons in Oklahoma banks for the benefit of those involved in such events, known as "statutory support trust accounts." The statute actually provides a form for a model trust to be used by a bank or trust company for the purpose of receiving money donated by any person as a public service to assist the beneficiary of the trust or account in the payment of medical, financial, educational, humanitarian or other similar needs.

The idea is that it can be either a deposit account established with the bank by a person serving as trustee of the depositing trust, or a trust account in the bank's trust department with the trust company or bank's trust department as trustee (or co-trustee). In either case, a reasonable fee may be charged by statute for the account. Typically these are simply a deposit account sought to be established by a well-meaning person who will serve as trustee (themselves and possibly with others) of the funds and deposit them with the bank as a deposit account. The bank needs to recognize that it is a Statutory Support Trust account and needs to make sure the customer uses the statutory form fully completed to fit the situation (if multiple signers on the account, then multiple trustees must appear on the form, etc…). The bank may have developed a form or have one included in their bank forms platform or archives. (There is no official regulatory guidance on these accounts or forms of which the author is aware.) The statutory form can be taken directly from the statute and placed in a document by anyone with access to the Internet at: http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=77122 . Bankers should not attempt to revise the form for their customer or give advice. It is up to the customer to correctly and properly complete the statutory form to fit their situation.

Customer and banker BOTH need to read, understand, and discuss the trust form so everyone is clear on what it means and how the administration of the account will be handled. For example, these trusts are irrevocable, so once established, cannot be revoked and the funds must be used for the express purposes of the trust. The banker may have them initial every Section of the Trust form. All grantors and trustees need to sign it and have it notarized for the banker to accept it as an account opening trust document.

NONE of the laws or requirements normally associated with deposit accounts is suspended or altered because of the nature of this account. Joint parties (trustees in this case) named as signers on the account will have access to all funds at any time and this should be clearly discussed with those involved. Sadly, it is an opportunity (whether at first or later as time goes on) for money laundering, so BSA, AML, CIP, IRS, etc., and all the bank's policies arising from the requirements of these laws and involving trust accounts are in full play and not in any way diminished. Unfortunately, since there is no official IRS recognition of a "statutory support trust" (to the knowledge of the author), whether these trusts require federal tax ID#s for themselves, or whether the social security #(s) of trustee(s) with signing authority on the account is sufficient for the IRS, is unknown to the author at this writing, but will be passed on as information is available. (Generally, irrevocable trusts have separate tax ID#s.) But as for the bank's purposes and requirements, obviously the account cannot be opened without a valid tax ID/SSN # of some sort, which is up to those creating the trust and serving as trustees to determine what they need and will use to open the account. So with all of this, the bottom line is that it is a deposit account and must be treated as such by the bank, even if this seems not in the spirit of the best intentions involved in a tragic situation.

The difference is that as part of the community, the community banker can implement these laws and policies with the community spirit and support that makes your customers better ready to see the trust funds through to the end while also feeling good about their contribution to those in need.

November 11, 2015

This is a REMINDER "compliance" note update that applies to ALL loans involving an Oklahoma mortgage, whether commercial, agricultural, or consumer.

This is a reminder from our September 2, 2015, *Weekly Compliance Update,* of this change in the law for release of a mortgage. **As of November 1, 2015, banks and other mortgage lenders holding a mortgage on Oklahoma real estate have only 30 days from the payoff of the mortgage debt to record a Release of Mortgage** vs. the 50 days that has been the standard for decades. If not released within the 30 days, the borrower (actually, the mortgagor who mortgaged the real estate whether or not that is the same as the borrower) may request the release in writing and the mortgage holder must release the mortgage within 10 days of the request or face statutory damages (1% of the principal debt per day up to $100 per day accruing up to the total principal amount of the debt, until the mortgage is released).

An occasional question regarding UCC fixture filings and whether this statute applies to these filings arises. The answer is that this statute does NOT apply to UCC fixture filings according to Oklahoma case law interpreting the statute. Nothing about the Nov 1 changes would appear to affect this.

The statute referenced above is 46 O.S. Supp. 2015 §15 and can be viewed in full here: http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=72042 .

December 3, 2015

DIVIDENDS RESTRICTED JAN 1, 2016 – *What??*

If you didn't realize that beginning January 1, 2016, your bank dividends and discretionary bonuses will be restricted differently by Federal Law than they ever have been before ***even if your bank is profitable and well capitalized***, it's time and almost past time to realize it. Thinking of pushing that dividend or bonus to next year? You may want to think again.

"But we're well capitalized, even under all the new Basel III capital rules with the new Common equity tier 1 capital ratio" you say. And indeed you are, but that may not be enough starting January 1, 2016.

That's because on top of the Basel III regulatory capital requirements already fully implemented, another layer of capital measure will become effective January 1, 2016, that is expressly and specifically for the purpose of restricting banks from paying dividends and discretionary bonuses if it is not met. It is called, the **capital conservation buffer**.

Under Basel III's new capital rules, the thresholds for prompt corrective action ("well capitalized," "adequately capitalized," etc…) actually don't effect the capital conservation buffer calculation: it's simply a different calculation of common equity tier 1 capital ("CET1") based on a percentage of total risk weighted assets. Think of it like a reserve account of CET1 that has to be funded over and above your base capital requirements. It is measured based only on calendar quarters.

So a bank can be "well-capitalized" without having a fully-funded capital conservation buffer. Thus, its freedom to pay dividends and discretionary bonus payments may still be restricted if it does not maintain a buffer of CET1 capital over each minimum capital ratio in an amount that is phased in over the next several years, 2016 – 2019, as follows:

0.625% in 2016;
1.25% in 2017;
1.875% in 2018;
2.50% in 2019.

So starting Jan. 1, 2016 and for the calendar year of 2016, this requires banks to hold CET1 in excess of minimum risk-based capital ratios by at least 0.625% to avoid limits on dividends and discretionary bonuses. That percentage goes up in 2017 to 1.25%, and so on. A more thorough and very helpful quick reference guide is available from each bank regulators website (starting near bottom of pg 2 of the guide):

OCC: http://www.occ.gov/news-issuances/news-releases/2013/2013-110b.pdf

FED:http://www.federalreserve.gov/bankinforeg/basel/files/capital_rule_community_bank_guide_20130709.pdf

FDIC: https://www.fdic.gov/news/news/financial/2014/fil14040.html

https://www.fdic.gov/regulations/capital/capital/Community_Bank_Guide_Expanded.pdf

And Note: This is in addition to the dividend calculation you typically make under Oklahoma law if you're a state chartered bank or national banking laws if you're a national bank, that involves basically your bank's previous 2 year's net income plus the current year's net income, minus capital distributions over the same period.

The wisdom of going ahead and paying a dividend or discretionary bonus in 2015 before these restrictions go into effect, is something only the bank and its board can best judge. We just want to make sure you realize you need to consider it. Paul R. Foster ©

December17, 2015

Don't overlook what examiners are checking: Are you correctly protecting Federal benefit funds for access by your customer from a garnished bank account?

In 2013, the federal procedures for protecting customer's federal benefits from garnishment were clarified and published. Banks were to implement procedures to make sure the mechanisms were in place to ensure customers' access to their federal benefit funds regardless of the garnishment. (Note: The regulation refers to "garnishment order" which is more than just garnishments and actually includes any execution, levy, attachment, garnishment, *or other legal process*. In this update, we simply refer to it as a "garnishment," but it includes all of those types of legal process including court or administrative orders for payment or freezing of funds.)

The purpose of this Compliance Note is to refresh this issue to make sure procedures are being implemented in this area. Adopting a policy demonstrates board commitment to the protections afforded by this law.

- Did you know that federal regulations require that prior to taking any other action related to a garnishment the financial institution is to examine the garnishment to determine if it includes a "Notice of Right to Garnish Federal Benefits"?
  --if you do this every time, do you have a written procedure demonstrating that this is so?
- Did you know that if no Notice of Right to Garnish Federal Benefits is included, that a review for protected federal benefit payments directly deposited into the customer's account must be conducted no later than two business days following the receipt of the garnishment.
  - --Do you have written procedure showing that you require this step?
  - --Do you have written procedure with the formula for the "lookback" period and the proper calculation of the protected amount?
  - --Do you take steps to ensure that the customer has full and customary access to the protected amount?
  - --Did you know that FR regulatory advice considers access to the protected amount via debit card (if one is issued to the customer) as part of "full and customary access"?
  - --Do you keep the records of the account activity and actions taken in response to the garnishment for at least two years from the date of receipt of the garnishment?

- Do you issue a notice to the account holder named in the garnishment if there are protected funds, the balance in the account on the date of the account review was above zero dollars ($0.00) & you've established the protected amount, and there are funds in excess of the protected amount?
    --Does this notice contain the required information? (There are eleven points covered in the Federal Reserve's exam checklist of this area.)
- Do you know how to charge your garnishment fee in a situation where the account has protected Federal benefits?

If any of these questions gave you pause—you can read 31 CFR part 212 for yourself (it is short for a regulation) and also the Federal Reserve Exam checklist at the end of the regulation.
http://www.federalreserve.gov/boarddocs/supmanual/cch/garnishment.pdf

Paul Foster Law Offices, P.C.
Oklahoma's Community Banking Attorneys

Paul R. Foster

Paul R. Foster is the President, Senior Shareholder and founder of Paul Foster Law Offices, P.C., located in Norman, Oklahoma. Mr. Foster's over thirty years of law practice have included twenty plus years of private practice and ten years as General Counsel for the Oklahoma State Banking Department, where in addition to serving as legal counsel to the Bank Commissioner and the State Banking Board, and working with Federal banking regulators on legal and regulatory issues, he was involved in numerous state and national bank regulatory and legal projects. These included the rewrite of the Oklahoma Banking Code and other state and federal banking laws, and serving as Chair of the Conference of State Bank Supervisors (CSBS) Legal Conference hosted by the National Judicial College.

Mr. Foster is currently in private practice advising and representing banks, holding companies, bank directors, officers and owners in a wide range of legal and regulatory matters. Mr. Foster has been an invited speaker for numerous banking and banking law seminars over the decades, and has spoken and taught at the local, regional and national levels, training bankers and their legal and regulatory counsel.

Mr. Foster has also served in officer and leadership roles, including Chairman and Program Director of the Oklahoma Bar Association's Financial Institutions and Commercial Law Section and as a member of the Oklahoma UCC Legislative Committee for Revised Article 9. Mr. Foster is privileged to have served as General Counsel for the Community Bankers Association of Oklahoma since 1999, and was the 2012 recipient of the CBAO's distinguished Chairman's Award. Mr. Foster has been named to *America's Best Lawyers* and *Oklahoma's Best Lawyers* by his peers and clients, has also received the *Lawyer of the Year Honor* for Financial Services Law for Oklahoma, and has been again named to this honor for 2016.