Compliance in the Real World: Areas of Concern for Today’s Auditor

Presented by:

Dan Huston, Partner
Regulatory Consulting
Moss Adams LLP

ACUIA Region I Meeting
IQ Credit Union, Vancouver, WA
September 28, 2012
WHAT YOU’LL TAKE AWAY TODAY

A better understanding of today’s key compliance concerns – what is likely to affect your credit union over the coming 12 months

A basic understanding of key risks and a more balanced perspective of compliance related risk in your credit union

Best practices and proven strategies for managing risk associated with current compliance issues
KEY COMPLIANCE ISSUES
DEPOSIT REGULATIONS
Common Criticisms

• Untimely responses to consumer disputes (debit cards, ATM, Point of Sale and ACH transactions)
• Inadequate notices when reversing provisional credits granted (reversal, 5 day overdraft provision)
• Be cautious of overlap between NACHA Rules and Regulation E (notice is still required)
ELECTRONIC FUNDS TRANSFER ACT

Risks

• Consumer may overdraw their account when credits are reversed, incurring additional fees
• If provisional credit is delayed or not given, consumer may not have access to funds
• Consumer may not understand the results of investigation or that the matter was resolved
• Resolution of errors is tied to Overdraft Protection Guidance (key exam focus area)
ELECTRONIC FUNDS TRANSFER ACT

Best Practices

• Monitor resolution times closely:
  o Management should be conducting self-tests of resolution logs

• Evaluate content of resolution letters for clarity and timeliness

• Procedures should include provision for ACH unauthorized transactions that fall within resolution requirements
Overdraft protection covers transactions that exceed the balance of your bank account. Just remember that the protection has a price.

FROM “MANAGING YOUR MONEY” PUBLICATION BY THE OCC, 2012
OVERDRAFT PROTECTION PROGRAMS

Notice of Request for Information, February 2012 (CFPB 2012-0007):

- Comprehensive call for information regarding overdraft protection products, practices and alternative to programs charging overdraft fees
- Comments were originally requested by the end of April 2012, but extended to the end of June 2012
- Results of the resulting study will be published in the near future
CFPB Comments on Overdraft Protection Programs (published in CFPB 2012-0007):

- “The long term impact of overdraft programs on consumer behavior and options is of particular interest to the Bureau.
- Some have argued that overdraft programs allow consumers to meet liquidity challenges, while
- Others argue that overdraft eventually adds to liquidity issues because of the high recurring fees that frequent overdrafters must pay.
OVERDRAFT PROTECTION PROGRAMS

• CFPB Comments on Overdraft Protection Programs (published in CFPB 2012-0007):
  o Further, there is concern that heavy use may lead a significant percentage of users to:
    ▪ Damage their credit records in databases institutions use to qualify consumers for checking accounts
    ▪ And thereby lose access to the services of competing providers or to the banking system altogether

  o To what extent are these various perspectives valid?
CONSUMER FINANCIAL PROTECTION BUREAU

Introduction of Suggested “Penalty Fee Box” Statement Format:

FEB 22 2012

Live from New York City!

BY THE CFPB WEB TEAM

Our live events on checking have ended. You can watch an archived recording of the morning roundtable below, or read Director Richard Cordray’s remarks. And make sure to check out the work on overdrafts that we announced:

- We’re researching how overdrafts affect you. We launched an inquiry through a data request that is being sent to a number of banks and a Notice and Request for Information to gain insight into overdraft practices.
- We want you to understand what actions you can take now to protect yourself from overdraft fees. Do you know your overdraft status? Read our Consumer Advisory that explains how you can learn whether or not you have opted in to debit overdraft fees on ATM and point-of-sale transactions.
- We’re working to make it easier for you to understand the costs and risks of overdraft programs. Our model overdraft “penalty fee box” is a thought-starter for a disclosure that would appear on your checking account statement and online banking landing page. It would highlight the amount overdrawn and total overdraft fees charged, so you so can clearly see how much overdrafts are costing you. Tell us what you think.
### Suggested Statement Format, CFPB, February 2012

#### ABC Bank

**Abigail Adams**  
1234 Main Street  
Anytown, AA 12345

**BRONZE CHECKING**  
Account Number: 1234567890  
Dates: 6/1/2012-7/1/2012

#### 30-day Statement Summary

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Previous balance</td>
<td>$320.40</td>
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<tr>
<td>All deposits/credits</td>
<td>+2,198.00</td>
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<tr>
<td>Interest earned 0.0% APY</td>
<td>+0.00</td>
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<tr>
<td>All checks/debits</td>
<td>-2,382.67</td>
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<tr>
<td>Service charges</td>
<td>-90.00</td>
</tr>
<tr>
<td>Total</td>
<td>-45.73</td>
</tr>
</tbody>
</table>

#### Overdraft-Related Fees

- **You have paid $90** in overdraft and non-sufficient funds fees this statement cycle.
- You overdrew $49.67 on your account this statement cycle to incur these fees.
- You can lower these fees. See the three tips at the end of this statement to learn how.

#### Data Description

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit</th>
<th>Deposit</th>
<th>Balance</th>
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*Example only, fictional data*
CONSUMER FINANCIAL PROTECTION BUREAU

Suggested Statement Format, CFPB, February 2012
OVERDRAFT PROTECTION PROGRAMS

Criticisms

• Inadequate disclosure of fees and costs to consumers ("Free Checking")
• Lack of, or inconsistent “opt-in” for overdraft protection programs for everyday ACH and Point of Sale Transactions ("A-9" forms)
• Lack of monitoring of consumer usage of programs (excessive fees)
• Posting patterns which encourage overdrafts (largest to smallest items posting)
OVERDRAFT PROTECTION PROGRAMS

Risks

• Charging fees not disclosed in consumer product information or advertising may be considered unfair or deceptive
• Opt-in and opt-out for ACH/POS transactions may change anytime – charging may not follow consumer selections (system coding and maintenance)
• Excessive fees assessed to consumers may appear unfair or abusive
• Posting large items first may tend to cause consumers to overdraw accounts more frequently or increase total fees paid when overdrafts occur
OVERDRAFT PROTECTION PROGRAMS

Best Practices

• Management should conduct regular review of product disclosures (compliance & legal) to ensure accuracy and clarity
  o Test products end-to-end (opening disclosures, system coding, statements) for consistency and accuracy
  o Labeling of fees should correlate to terminology used in product disclosures
OVERDRAFT PROTECTION PROGRAMS

Best Practices

• Verify system coding correlates to current “Opt-In” selections
  o Select consumers that change “Opt-In” status to verify system coding regulating charging is updated

• Review linked products (overdraft savings, etc.) for fees
  o If transfer charges are assessed, but not disclosed on “free” products, may be construed as unfair or deceptive
UNFAIR, DECEPTIVE AND ABUSIVE ACTS AND PRACTICES
UNFAIR, DECEPTIVE AND ABUSIVE ACTS AND PRACTICES - UDAAP

Issues

• Deceptive advertising ("free", "no-cost", hidden costs)
• Abusive collection practices (coercion, practices contrary to FDCPA rules)
• Inaccurate customer disclosures (fees, costs, product features)
• Lack of required verbal disclosures (costs, including APR, APY, specific product features)
• Charging customers when not authorized (overdraft programs, regular account fees)
UNFAIR, DECEPTIVE AND ABUSIVE ACTS AND PRACTICES - UDAAP

Best Practices

• Establish policies and procedures for managing complaints and monitor them closely
  o Categorize by Regulation
  o Establish standards for response and report trends to the Board of Directors
  o Be prepared to reimburse consumers through approved policies and procedures when non-compliance is identified

• Document review and approval of consumer brochures and disclosures
  o Establish procedures for review by compliance and legal
  o Document reviews
LENDING REGULATIONS
SERVICE MEMBER CIVIL RELIEF ACT

Criticisms

• Foreclosure practices, required notices
• Identification of alternatives to service members and families
• Products which appear to abuse service members (high cost products)
HOME MORTGAGE DISCLOSURE ACT (HMDA)

Key Point: Accuracy of Data

• The old error allowance percentage in examination was generally 5%
• Today’s allowable error rate is 3% or less

Why?
DATA IS USED IN EVALUATION FOR FAIR LENDING ISSUES
FAIR LENDING PROGRAM

Criticisms

• Timely notification of results of credit decisions
• Decision models which appear to include unfair criteria
• Higher pricing for approved loans made to protected classes (minorities, women), particularly 1-4 family secured loans
• Practices which appear to discourage application
FAIR LENDING PROGRAM

Best Practices

• Complete a fair lending risk assessment including
  o Products, services, lending areas
  o Track delivery of products across geographies served
• Test member notifications such as adverse actions and disclosures frequently
• Audit compliance monitoring for effectiveness
REGULATORY IMPLEMENTATIONS ON THE HORIZON
## REGULATORY CHANGES

<table>
<thead>
<tr>
<th>Regulatory Subject</th>
<th>Summary of Changes</th>
<th>Status</th>
<th>Anticipated Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclosure Rules for Remittance Transactions (Regulation E, 12 CFR 1005)</td>
<td>Implements mandatory changes under Dodd Frank Act which requires disclosures are provided to consumers regarding fees, applicable exchange rates and amounts of currency to be received by beneficiaries of remittance transfers, and includes refund and error resolution rights</td>
<td>Notice of proposed rulemaking (NPRM) was issued on February 7, 2012, final comments closed April 9, 2012</td>
<td>August 2012</td>
</tr>
<tr>
<td>Integrated Mortgage Disclosures (RESPA, 12 CFR 1024; and TILA Combined Disclosures, 12 CFR 1026)</td>
<td>Combines current required consumer disclosures under Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA)</td>
<td>Comment period closes September 7, 2012 (and November 6, 2012 for certain sections)</td>
<td>January 2013</td>
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<td>High Cost Mortgages and Homeownership Counseling (RESPA, 12 CFR 1024; and TILA, 12 CFR 1026)</td>
<td>Revises the trigger for coverage under provisions of the regulation for loans considered “high cost” and implements pre-loan counseling requirements</td>
<td>Comment period closes September 7, 2012</td>
<td>January 2013</td>
</tr>
<tr>
<td>Ability to Repay (TILA 12 CFR 1026)</td>
<td>Expands existing rules currently applied only to higher cost mortgage loans regarding the applicant’s ability to repay the loan to all loans secured by 1-4 family housing</td>
<td>Notice of proposed rulemaking was issued on May 11, 2011. The comment period was extended to July 22, 2011</td>
<td>Required to be final by January 21, 2013, implementation in early 2013</td>
</tr>
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<td>Mortgage Originator Standards (TILA, 12 CFR 1026.36)</td>
<td>CFPB will issue guidance clarifying the use of the unique identifier, payment of discount points and origination fees and qualification requirements for loan originators.</td>
<td>Notice of proposed rulemaking (NPRM) to be issued in August 2012</td>
<td>Early 2013</td>
</tr>
<tr>
<td>Provision of Valuation (appraisal) to Applicants (ECOA, 12 CFR 1002.14)</td>
<td>Implements mandatory changes under Dodd Frank Act requiring lenders to provide a copy of appraisals obtained by the lender automatically to loan applicants. Eliminates current option to provide a notice to applicants of availability of a copy of appraisal upon request</td>
<td>Notice of proposed rulemaking scheduled to occur in July 2012</td>
<td>Required to be final by January 21, 2013, implementation in early 2013</td>
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<td>Mortgage Servicing Standards RESPA and TILA, 12 CFR 1026</td>
<td>Imposes mandatory changes under Dodd Frank Act to mortgage servicing standards including periodic statement disclosures, error resolution and response standards to complaints; standards regarding force-placed hazard insurance; prompt crediting and handling of loan payoffs and other considered changes.</td>
<td>Notice of proposed rulemaking was scheduled to occur in July 2012; JUST PROPOSED FOR COMMENT ON AUGUST 10, 2012</td>
<td>Required to be final by January 21, 2013, implementation in early 2013</td>
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QUESTIONS

How frequently are you conducting compliance audits?

How do you audit newly implemented regulations?

Do you audit for monitoring of upcoming changes?