EXAMINING CHANGES AT THE CFPB

Capco Center of Regulatory Intelligence

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EDITORIAL NOTE FROM THE MANAGING PRINCIPAL, CENTER OF REGULATORY INTELLIGENCE

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At Capco's Center of Regulatory Intelligence (CRI), we pay special attention to the direction of federal agencies and regulators to help our clients understand where an agency is headed. This constant surveillance keeps a financial institutions and their compliance programs proactive and limits surprises, which often lead to extended costs in either time or capital. For this reason, the Regulatory Intelligence Briefing's (RIB's) main article focuses on the shift in the Consumer Financial Protection Bureau (CFPB) since Richard Cordray stepped down in November 2017.

In late February, the Government Accountability Office (GAO) issued a report addressing compliance burdens. The report specifically listed a number of CFPB rules as causing "unnecessary" burden on financial institutions. This led to the GAO recommending the agency re-examine its guidance around its rules. This fits into what new CFPB Acting Director Mick Mulvaney is doing through requests for information, in attempting to "ensure the Bureau if fulfilling its proper and appropriate functions to best protect customers." The RIB's main article this month highlights these reports and other actions and issuances that may give insight into agency's direction.

Our secondary article provides an update on de-risking. Pushed into the spotlight by a recent GAO report related to de-risking along the southwest border, the article explores some of the legislative proposal related to the practice, regulatory focus on the activity and some of the potential downsides to the practice. Additionally, we address some potential fair lending concerns associated with de-risking in certain areas.

The Legislative Outlook focuses on the Senate's financial reform package that recently passed the Senate. After receiving significant amendments from the Senate floor, the article makes some comparisons to the reform bill passed in the House. Specifically, the Senate added capital market provisions and changes to mortgage lending.

CRI remains apprised of all regulatory trends and changes. We hope to provide our clients with the most cutting-edge information to keep the institutions we serve informed and prepared.

REGULATORY ROUNDUP

Regulatory and Compliance Alerts

FRB Releases Summary of Secure Payments Task Force Next Steps

On March 1, 2018, the Federal Reserve Board (FRB) provided a summary of next steps for the Secure Payments Task Force, which will conclude its efforts in March 2018 with a final publication consisting of a collection of educational materials outlining the lifecycles and security profiles of today's primary payment methods.

CFPB Issues Final Amendments to Mortgage Servicing Rules

On March 8, 2018, the Consumer Financial Protection Bureau (CFPB) issued a final rule to help mortgage servicers communicate with certain borrowers facing bankruptcy. The final rule gives mortgage servicers more latitude in providing periodic statements to consumers entering or exiting bankruptcy, as required by the CFPB's 2016 mortgage servicing rule. **The effective date for the rule is April 19, 2018.**

Department of Education Issues Interpretation Notice regarding Federal Preemption in Student Loan Servicing

On March 12, 2018, the Department of Education issued an interpretation notice to clarify Federal interests in the regulatory oversight of student loan servicers involved in servicing the department's Direct Loan Program. The notice outlines the Department's interpretation of federal preemption as it relates to various state regulations that may establish conflicting requirements for certain loan servicers.

Basel Committee Proposes Revisions to Minimum Capital Requirements for Market Risk

On March 22, 2018, Basel Committee on Banking Supervision (BCBS) proposed revisions to the minimum capital requirements for market risk, to address issues BCBS identified in the course of monitoring the implementation and impact of the market risk standard issued in January 2016. **Comments are due by June 20, 2018.**

NCUA Issues Legal Opinion on Loan Participations

On March 22, 2018, the National Credit Union Administration (NCUA) issued a legal opinion letter regarding loan participation transactions and the applicability of the NCUA's loan participation regulation throughout the life of the transaction.

FINRA Updates Designation Criteria for Participation in FINRA's Business Continuity/Disaster Recovery Testing

On March 7, 2018, FINRA published a notice to update the criteria in Notice 15-43 to include criteria for designating firms that report a significant volume of transactions in U.S. Treasury securities to TRACE for mandatory business continuity and disaster recovery testing participation.

LEGISLATIVE OUTLOOK:
ECONOMIC GROWTH, REGULATORY RELIEF AND CONSUMER PROTECTION ACT

On March 14, the Senate passed the Economic Growth, Regulatory Relief and Consumer Protection Act (S. 2155). The bill serves as the Senate's major regulatory reform package. While much of the original bill remains intact from introduction, the version that passed the Senate made significant additions to the bill. Many of the changes are language found in bills already introduced into Congress, some of which have passed their house of origination.

The language added to S. 2155 comes from some of the following bills:

Bill Number	Title	Pass House of Origin
H.R. 1219	Supporting America's Innovators Act of 2017	Yes
H.R. 1257	Securities and Exchange Commission Overpayment Credit Act	No
H.R. 1343	Encouraging Employee Ownership Act of 2017	Yes
H.R. 1661	Affordable Housing Credit Improvement Act of 2017	No
H.R. 1685/ S. 699	Honor Our Commitment Act of 2017	No
H.R. 2148	Clarifying Commercial Real Estate Loans	Yes
H.R. 2864	Improving Access to Capital Act	Yes
S. 484	U.S. Territories Investor Protection Act of 2017	Yes
S. 2304	Protecting Veterans from Predatory Lending Act of 2018	No

The bill is now broken out into six titles, up from five when it passed the Senate Banking, Housing, and Urban Affairs Committee in December 2017.

- **I.** Improving Consumer Access to Mortgage Credit
- **II.** Regulatory Relief and Protecting Consumer Access to Credit
- **III.** Protections for Veterans, Consumers and Homeowners
- **IV.** Tailoring Regulations for Certain Bank Holding Companies
- **V.** Encouraging Capital Formation
- **VI.** Protections for Student Borrowers

In the previous version of the bill, Title V was devoted to studies that various executive agencies were to complete. Instead, there is now a new title devoted to capital formation. These studies have been dispersed throughout the bill and Titles V and VI have taken on certain provisions that other titles contained in the bill's previous version.

Importantly, the bill is now with the House of Representatives, which passed its own financial services reform bill in June 2017. The House reform package, the Financial CHOICE Act (FCA), proposed some of the following reforms:

- Eliminating the Orderly Liquidation Authority
- Amending CCAR and DFAST Stress Testing
- Setting more formal cost-benefit analysis and regulatory analysis related to agency rulemaking
- Changing the leadership structure at certain agencies
- Removing "Chevron" deference for financial regulatory agencies
- Lowering certain regulatory thresholds applicable to main street and community banks and exempting those institutions from other regulations entirely
- Overhauling the CFPB and renaming it the Consumer Law Enforcement Agency (CLEA)
- Repealing the Durbin Amendment

It is unknown at this point if the House will pass S. 2155, whether the bill will go to a conference committee to see if a resolution can be made between the different houses or if it will take no action. Below is a breakdown of the bill by title with some comparison to the House's FCA to emphasize where compromises might be sought in the coming months.

TITLE I: Improving Consumer Access to Mortgage Credit

The first title of the Senate bill eases numerous regulations to make mortgage lending easier for lenders, and in turn, consumers. It does this by creating safe harbors, removing restrictions and exempting certain mortgage originators from requirements. Specifically, the bill proposes nine changes:

- Certain mortgage loans that an insured depository institution or an insured credit union with less than $10 billion in total consolidated assets originates and retains in portfolio will be deemed "qualified mortgages" under Regulation Z (Truth in Lending Act (TILA)) while maintaining consumer protections.
- Voluntary appraisal services that an appraiser donates to an organization eligible to receive tax-deductible charitable contributions will be considered "customary and reasonable."
- Certain mortgage loans with a balance of less than $400,000 will be exempt from appraisal requirements under the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) if the originator is unable to find a state certified or licensed appraiser to perform an appraisal after a good faith effort.
- Small depository institutions (those that have originated less than 500 closed-end mortgage loans or less than 500 open-end lines of credit in each of the two preceding calendar years) will be exempt from certain disclosure requirements under Regulation C (Home Mortgage Disclosure Act (HMDA)) and a study is required on the impact on the amount of data available.
- The limitation is removed that a one-to-four family dwelling that is not the primary residence of a member will not be considered a member business loan under the Federal Credit Union Act.
- Individuals will be given temporary authority to act as a loan originator for 120 days if they are (a) a registered loan originator who becomes employed by a state-licensed mortgage company or (b) a state-licensed loan originator who becomes employed by a state-licensed mortgage company in a different state.
- An employee of a retailer of manufactured or modular homes that does not receive compensation or gain is excluded from the definition of "mortgage originator" under TILA.
- Certain loans made by an insured depository institution or an insured credit union are exempt from escrow requirements under TILA.
- The three-day wait period required for combined TILA/Regulation X (Real Estate Settlement Procedures Act (RESPA)) mortgage disclosure is removed if a creditor extends a second offer of credit to a consumer with a lower annual percentage rate. The wait period also expresses congressional sentiment that the CFPB should provide clearer, authoritative guidance on TILA/RESPA Integrated Disclosure (TRID) and other areas under CFPB jurisdiction.

Comparison to the FCA: The FCA makes many more broad changes to the CFPB. S. 2155 only requires the CFPB to issue more guidance related to TRID. The FCA makes similar changes related to retailers of manufactured homes and safe harbors for loans a depository institution keeps on its balance sheet.

TITLE II: Regulatory Relief and Protecting Consumer Access to Credit

The second title of the bill provides regulatory relief for financial institutions similar to efforts seen in the past. For example, it:

- Requires a community bank leverage ratio of tangible equity to average consolidated assets of between 8 and 10 percent
- Presumes banks with less than $10 billion in total assets who maintain tangible equity in an amount that exceeds the community bank leverage ratio will be compliant with capital and leverage requirements
- Exempts banks from the Volcker rule if they have less than $10 billion in total consolidated assets and have less than 5 percent of their total consolidated assets as trading assets and trading liabilitie

Additionally, the bill:

- Reduces reporting requirements for depository institutions with less than $5 billion in total consolidated assets that satisfy other criteria,
- Removes naming restrictions related to bank-affiliated investment advisers
- Raises the consolidated asset threshold of the small bank holding company policy statement from $1 billion to $3 billion
- Allows well-managed and well-capitalized banks with consolidated assets under $3 billion to qualify for an 18-month examination cycle
- Requires changes to the National Credit Union Administration (NCUA) budgeting process
- Streamlines certain requirements for small public housing authorities operating in rural area
- Eases regulations for certain federal savings associations with less than $15 billion in total consolidated assets
- Creates an exception for certain reciprocal deposits
- Gives exemptions from state regulation for listing on securities exchanges
- Creates new requirements for online banking initiation
- Establishes the Insurance Policy Advisory Committee at the Federal Reserve Board (FRB)
- Applies Regulation CC (Expedited Funds Availability Act) to different U.S. commonwealths and territories

The version of S. 2155 that passed the entire Senate also had the following provisions added on the Senate floor:

- Prohibiting a federal banking agency from subjecting a depository institution to higher capital standards with respect to a high-volatility commercial real-estate (HVCRE) exposure unless the exposure is an HVCRE acquisition, development or construction loan
- Facilitating the validation of fraud data protection to reduce the prevalence of synthetic identify fraud
- Requiring the Department of Treasury (Treasury) to create a report on risks for U.S. financial institutions and capital markets from cyber threats
- Lowering the maximum amount of surplus funds of Federal reserve banks from $7.5 billion to $6.825 billion

Comparison to the FCA: The leverage ratio for the FCA's off-ramp is greater than 10 percent, but there is no cap for the size of the financial institution, unlike the Senate's bill. The FCA also fully repeals the Volcker rule, instead of having the requirements outlined in S. 2155. Both bills would alleviate some of the reporting requirements for community banks and raise the small company holding policy threshold, although the FCA puts that at $10 billion instead of the $3 billion proposed in S. 2155. Both bills also expand the reach of the Expedited Funds Availability Act to certain U.S. commonwealths and territories and allow federal savings associations to operate with the rights and duties of national banks subject to certain restrictions.

But, the FCA does not address the examination cycles for smaller financial institutions, nor is it as specific in many of its carve-outs. The Senate bill sets firm dollar thresholds for much of its relief, and compared to the FCA, those thresholds appear to be more conservative.

TITLE III: Protections for Veterans, Consumers and Homeowners

The Senate bill also has a specific title dedicated to protecting consumers. This title:

- Protects consumers' credit by providing consumers free freeze and unfreeze alerts as well as requiring fraud alerts' inclusion in a consumer's file under certain circumstances
- Excludes from consumer reporting information certain medical debt a veteran incurs
- Establishes a dispute process for consumer reporting agencies regarding veterans' medical debt
- Provides protections to helping elders suspected of financial exploitations
- Restores the Protecting Tenants at Foreclosure Act of 2009
- Authorizes Treasury to remediate lead and asbestos hazards in residential properties
- Continues administration of local Family Self-Sufficiency programs
- Requires the CFPB to create new regulations related to "Property Assessed Clean Energy financing"
- Instructs the Government Accountability Office (GAO) to submit a report to the Senate Banking, Housing, and Urban Affairs Committee and the House Financial Services Committee on the regulatory structure of consumer reporting agencies, including an analysis of any gaps in that structure
- Protects veterans from predatory lending by, among other things, requiring: lenders to make certifications about the cost of veterans' loans; refinance loans to be at least 50 basis points lower than the earlier fixed-rate loan; and specified time periods to take place between an initial loan and a refinance loan
- Allows Fannie Mae and Freddie Mac, when determining whether to purchase a residential mortgage, to consider a borrower's credit score only if certain procedural requirements are met with respect to the validation and approval of credit-scoring models
- Requires the GAO to produce a report on Puerto Rican housing market following Hurricane Maria
- Instructs the Department of Housing and Urban Development (HUD) to submit a report to Congress that includes an overview and recommendations for lead-based paint hazard prevention and abatement
- Makes permanent the extended period of protections for members of uniformed services relating to mortgages, mortgage foreclosure and eviction, among other things

Comparison to the FCA: There is not a lot of overlap between this title and the FCA. Probably spurred by the 2017 data breach at a large consumer credit reporting agency, discovered after the FCA's introduction, it is not surprising that the Senate bill makes credit reporting a priority.

However, both the House and Senate versions carry the Senior Safe Act (H.R. 3758/S. 223).

TITLE IV: Tailoring Regulations for Certain Bank Holding Companies

While this title was unchanged by the Senate floor amendments, it still contains of the biggest changes covered in the regulatory reform bill by raising the threshold for applying enhanced prudential standards. Specifically, the bill increases the threshold from $50 billion to $250 billion. For bank holding companies with total consolidated assets between $50 billion and $100 million, the exemption ould apply immediately. Bank holding companies with total consolidated assets between $100 billion and $250 billion will be exempt 18 months after the bill's effective date, but those banks will see additional enhanced prudential standards from the FRB, and unless the FRB exempts the bank, be required to conduct supervisory stress tests.

This title also makes changes to the supplementary leverage ratio final rule and directs the FDIC, FRB and OCC to classify qualifying investment-grade, liquid and readily-marketable municipal securities as level 2B liquid assets under the agencies' Liquidity Coverage Ratio final rule.

Comparison to the FCA: The FCA also raises the threshold for applying enhanced prudential standards. Instead of setting a dollar threshold, the application would be based on risk-related factors. The FCA also addresses the supplemental leverage ratio, but does not mention the OCC's Liquidity Coverage Ratio final rule.

TITLE V: Encouraging Capital Formation

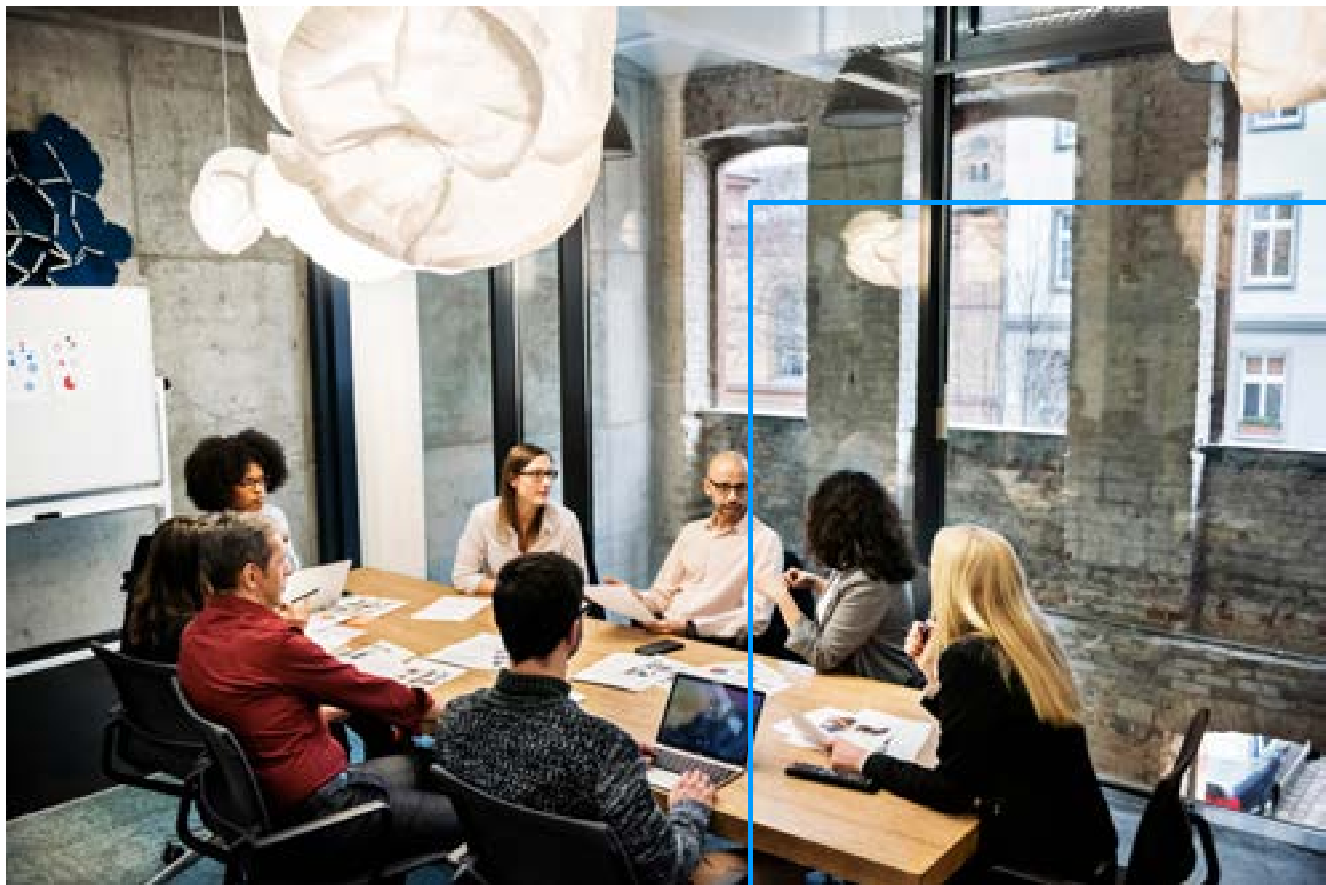
This is a new title in the bill. It is made up of two sections from the previous version of the bill that have been moved to Title V and a bunch of new sections. The first original provision addresses an exemption from state regulation for securities offerings that are listed or authorized for listing on "a" national securities exchange, rather than naming a specific securities exchange. The second provision requires the SEC to prepare a report for Congress on the risks and benefits of algorithmic trading in capital markets.

The other seven provisions in S. 2155 are new. The added language: requires the SEC to review findings and recommendations of the government-business forum on capital formation; exempts certain smaller venture capital funds from the definition of an "investment company"; requires the SEC to offset future fees and assessments due from a national securities exchange or association under certain conditions; applies the Investment Company Act of 1940 to companies created under the laws of Puerto Rico, the Virgin Islands or any other U.S. possession; increases the 12-month sales threshold from $5 million to $10 million, beyond which an issuer is required to provide investors with additional disclosures related to compensatory benefit plans; exempts certain issuers from registration requirements; and requires the SEC to finalize rules within two years allowing any registered "closed-end company" to use the securities offering and proxy rules, subject to conditions, that are available to other issuers that are required to file reports under Section 13 or Section 15(d) of the Securities Exchange Act.

Originally, the last title in S. 2155., Title V outlined three studies for different agencies to perform. The newer version of the bill has dispersed these studies to other titles.

- In Title II: Treasury must submit a report to Congress on the risks of cyberthreats to financial institutions and the U.S. capital markets.
- In Title III: The Government Accountability Office (GAO) must submit a report to the Senate Banking, Housing, and Urban Affairs Committee and the House Financial Services Committee a report on the regulatory structure of consumer reporting agencies, including an analysis of any gaps in that structure.
- In Title V: The SEC must report to Congress on the risks and benefits of algorithmic trading in capital markets.

Comparison to the FCA: There is substantial overlap between Title V and the FCA. The FCA contained either identical or almost identical language for five of the nine sections of Title V. This included the overpayment credit provisions; the rulemaking related to closed-end companies using the securities offering and proxy rules; the annual review of the government-business forum; the SEC requirement to offset future fees and assessments due from a national securities exchange or association under certain conditions; and application of the Investment Company Act to territories and possessions of the U.S.



TITLE VI: Protections for Student Borrowers

This is another new title in the most recent version of S. 2155. While one provision of the new Title VI existed in the previous version of the bill, the other two provisions in this section are new. The carryover provision allows consumers to request that a financial institution remove a reported default of a private education loan from a consumer report in certain instances. The other two sections provide increased protections in the event of death or bankruptcy and require establishment of best practices for institutions of higher education to improve financial literacy.

Comparison to the FCA: The FCA does not directly address student lending or financial literacy. ❖

FOCUS

AGENCY IN FLUX: CHANGES AT THE CFPB

A shift has begun at the Consumer Financial Protection Bureau (CFPB). The agency that has been at the center of the partisan, financial services reform conversation since 2010 is undergoing a change in direction.

The Dodd-Frank Act, signed into law in June 2010, created the CFPB with the goal of consolidating federal consumer financial protection authority into one place. CFPB took on authorities from seven federal agencies, and since the agency began operations in July 2011, it has garnered severe political debate and tension. One particular topic of debate is the agency's unique independence, which its directorship structure grants: the director position is a five-year term, not removable at will. Republicans have believed since the CFPB's inception that this position holds too much power, and under a Democratic administration, Republicans fought to restructure the agency. However, with a recent shift in directorship, it is important to monitor whether Republicans will continue to push for reform.

A Recent History of the CFPB

In the words of former CFPB Director Richard Cordray upon his departure from the agency near the end of 2017, the agency's accomplishments included: "$12 billion in relief recovered for nearly 30 million consumers; stronger safeguards against irresponsible mortgage practices that caused the financial crisis and hurt millions of Americans; giving people a voice by handling over 1.3 million complaints that led to problems getting fixed for vast numbers of individuals, and creating new ways to bring financial education to the public so that people can take more control over their economic lives."

But, when President Donald Trump took office, he vowed to make changes to the agency. In February 2017, Trump issued Executive Order 13772, Presidential Executive Order on Core Principles for Regulating the United States Financial System, which required the Department of the Treasury (Treasury) to release a report to identify and provide recommendations for reform in any areas inconsistent with or inhibiting a financial system in line with the Core Principles. The report, published in June 2017, outlined major changes to the CFPB.

In the report, Treasury stated their opinion that the CFPB has largely failed in its goals of creating and maintaining a stable financial regulatory market. The report identified issues within the CFPB's leadership structure, funds management, conduct, actions and security structure; and asserted that the CFPB is "unaccountable to the American people" and that its "substantive authority is unduly broad, ill-defined, and susceptible to abuse."

Due to the CFPB's status as an independent agency, it was not required to make any of the changes the report suggested, and at the time the Treasury released the report, Obama-appointee Cordray directed the agency. Many speculated that a director whose priorities more closely aligned with the Trump administration's would be more likely to implement some of the proposed reforms. Fueling this belief was the fact that the House Financial CHOICE Act, which passed the House in July 2017, reflected many of the Treasury report's proposed changes.

When Cordray stepped down at the end of November 2017, however, his departure created brief confusion and uncertainty. The CFPB issued a press release stating Leandra English, chief of staff for the agency, had been named deputy director, replacing Cordray on an interim basis, and likely longer-term, as the agency head. But, on the same day, Trump announced Office of Management and Budget (OMB) Director Mick Mulvaney as the Acting Director of the CFPB. This led to a lawsuit from English, acting as a private citizen, against Trump. The lawsuit sought a temporary restraining order, preventing Trump from appointing an acting director for the agency. The U.S. District Court for the District of Columbia eventually rejected English's suit, allowing Mulvaney to continue acting as director of the agency.

Proposed Legislation to Reform the CFPB

Since the CFPB opened its doors, Republicans have fought to reform the agency. This sustained effort has continued into the current Trump administration.

In addition to the recommendations found in the Treasury report and the proposed legislation regarding the CFPB in the Financial CHOICE Act, on March 14, 2018, the House introduced a bipartisan bill to attempt to find compromise on the polarizing subject. The Financial Product Safety Commission Act of 2018 (H.R. 5266) would create a bipartisan five-member commission to lead the CFPB (replacing the model of single director, removable-at-will) and change the CFPB's name to the "Financial Product Safety Commission."

Leadership Uncertainty: The Legal Battle

The legal debate over new CFPB leadership focuses on uncertainty from two federal acts: The Dodd-Frank Act and the Federal Vacancies Act.

Dodd-Frank Act	Federal Vacancies Act
The CFPB's Deputy Director shall "serve as acting Director in the absence or unavailability of the Director." 12 U.S.C. § 5491(b)(5).	The President has the authority to temporarily authorize "an acting official to perform the function and duties" of an officer of an Executive agency whose appointment "is required to be made by the President, by and with the advice and consent of the Senate," and it is the "exclusive means" for authorizing acting service "unless" another statute expressly designates an officer to serve in an acting capacity or provides an alternative means for a designation as an acting officer. 5 U.S.C. § 3347(a).

The Department of Justice also released a memorandum supporting the Trump administration's appointment under the Federal Vacancies Act.

Mulvaney made clear early on that his approach in leading the CFPB will be entirely different from Cordray's approach. In a memo to all CFPB employees, Mulvaney wrote that he had read an article in which Cordray stated, "We wanted to send a message: There's a new cop on the beat… Pushing the envelope is a loaded phrase, but that's absolutely what we did." Mulvaney's response was, "It is not appropriate for any government entity to 'push the envelope' when it comes into conflict with our citizens." Mulvaney's memo also outlined the ways in which the CFPB will no longer "go beyond the law" in its enforcement or regulation interpretation.

Along similar lines, Mulvaney has also said that one of his goals as acting director is to "try and limit, as much as we can, what the CFPB does to sort of interfere with capitalism and with financial service markets." In his first budget request to the Federal Reserve Board (FRB) in January 2018, Mulvaney requested no funding for the agency's upcoming fiscal quarter, proposing that he would use the $177 million reserve to cover the $145 million projected operating costs.

The following month, the Trump administration revealed its budget plan, which contained plans to sharply reduce the budget for the CFPB over the next two years as it additionally restricts the agency's enforcement authority to "prevent actions that unduly burden the financial industry and consumer choice." The budget plan would cap the agency's budget at $485 million for FY2019, equivalent to the 2015 level — almost $150 million under the requested budget for FY2018 — and $610 million for 2020. This two-year "restructuring period" is intended to allow for an "efficient transition" of the agency as it seeks to impose "financial discipline" and "reduce wasteful spending." Trump has shared his hopes to bring the CFPB's budget under congressional oversight by 2020. Until these reforms take effect, the CFPB will continue to receive funds from the FRB based on requests from the agency leadership, and unrelated to the federal government budget.

Shifts in CFPB Goals and Functioning

One of the most apparent and solid developments that portrays the CFPB's shift in focus is the new strategic plan for fiscal years 2018 – 2022, which the agency released in February. On the surface, the plan looks like a fairly straight-forward document that outlines the agency's main objectives for the next five years, listing three specific goals:

Goal 1. Ensure that all consumers have access to markets for consumer financial products and services.

Goal 2. Implement and enforce the law consistently to ensure that markets for consumer financial products and services are fair, transparent and competitive.

Goal 3. Foster operational excellence through efficient and effective processes, governance and security of resources and information.

However, when compared to a previous draft of the agency's strategic plan, the document provides much more insight. A draft strategy released in October 2017, under Cordray's leadership, outlined four goals:

Goal 1. Prevent financial harm to consumers while promoting good practices that work for consumers, responsible providers and the economy as a whole.

Goal 2. Empower consumers to make informed financial choices to reach their own life goals and enhance their own financial well-being.

Goal 3. Inform the public, policy makers and the CFPB's own policy-making with market intelligence and data-driven analysis of consumer financial markets and consumer behavior.

Goal 4. Advance the CFPB's performance by maximizing resource productivity.

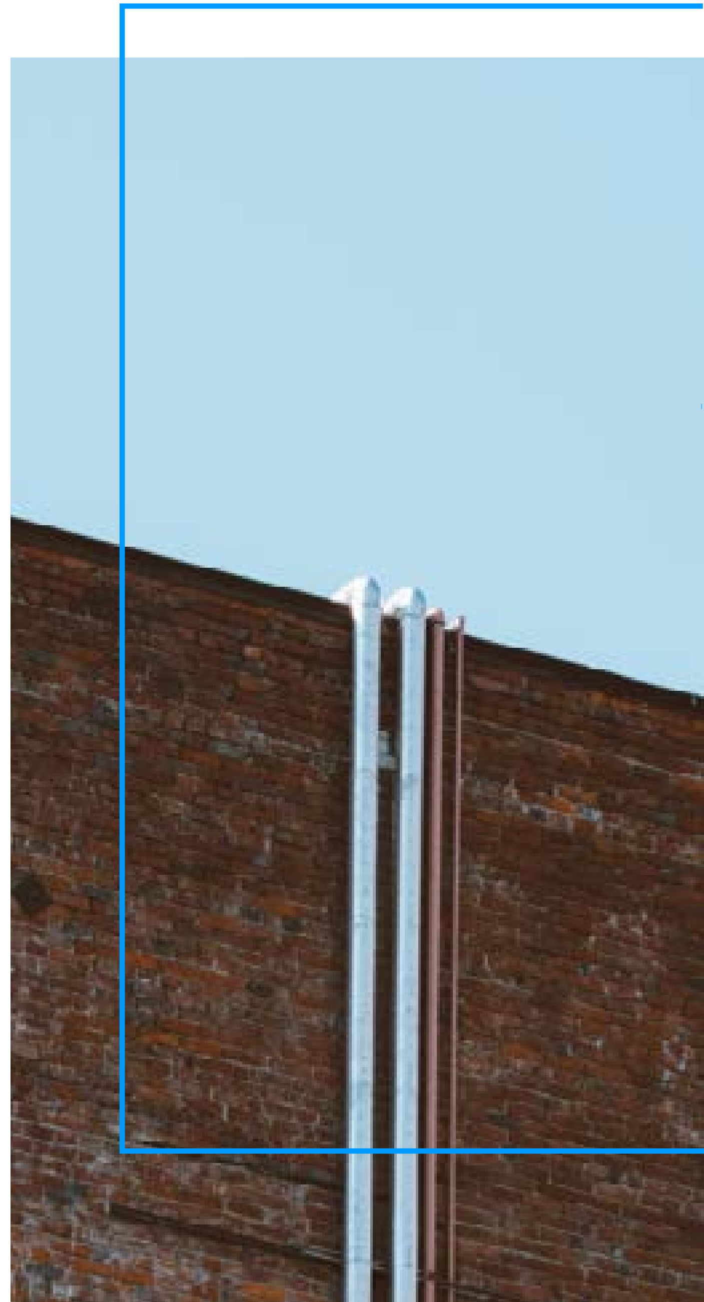
Even a quick comparison of the two different types of goals suggests a potential shift in the agency's operations and actions moving forward. The new CFPB goals do not mention helping consumers make financial decisions; instead the plan focuses on helping consumers access markets. Consumer education is often an area that comes under political debate. The draft language also emphasized the importance of data-driven analysis of consumer financial markets and consumer behavior. However, the final strategic plan makes no mention of this.

Mulvaney also made the following statement accompanying the plan's release: "If there is one way to summarize the strategic changes occurring at the Bureau, it is this: we have committed to fulfill the Bureau's statutory responsibilities, but go no further. By hewing to the statute, this Strategic Plan provides the Bureau a ready roadmap, a touchstone with a fixed meaning that should serve as a bulwark against the misuse of our unparalleled powers."

Requests for Information

Mulvaney has also released 10 in a series of twelve Requests for Information (RFIs) as a part of a call for evidence, which the agency says it will use as a tool to help "ensure the Bureau is fulfilling its proper and appropriate functions to best protect consumers." These RFIs include:

- January 24: Civil Investigative Demands
- January 31: Administrative Adjudications
- February 7: Enforcement Processes
- February 14: Supervision Program
- February 21: External Engagements
- March 1: Consumer Complaint Reporting
- March 7: Rulemaking Process
- March 14: Adopted Regulations and New Rulemaking Authorities
- March 25: Inherited Regulations and Inherited Rulemaking Authority
- March 28: Guidance and Implementation Support
- Consumer Education (forthcoming, as of date of this article's publication)
- Consumer Inquiries (forthcoming, as of date of this article's publication)



Changes to Rules and Regulations under CFPB Jurisdiction

KBYO/TRID

On February 27, 2018, the Government Accountability Office (GAO) issued a report entitled, "Community Banks and Credit Unions: Regulators Could Take Additional Steps to Address Compliance Burdens." The 79-page report made ten recommendations for executive action, including that the CFPB should assess the effectiveness of its Know Before You Owe (KBYO) Mortgage Disclosure Rule's (also known as the TILA-RESPA Integrated Disclosure Rule (TRID)) guidance "to determine the extent to which [KBYO]'s requirements are accurately understood and take steps to address any issues as necessary."

To make its conclusions and recommendations, the GAO reached out to over 60 community banks and credit unions. Specifically, the GAO examined "(1) the regulations community banks and credit unions viewed as most burdensome and why, and (2) efforts by depository institution regulators to reduce any regulatory burden."

In relation to KBYO, some of the interviewed financial institutions indicated they had to hire additional staff to comply with the requirements. In one GAO poll, 40 of 43 individuals from institutions participating in focus groups said they had to expand their training program due to the need for staff to understand new requirements.

While the GAO acknowledged that the new regulations could be creating unnecessary compliance burdens, the recommendations focused on agency-issued guidance. As part of the review, the GAO said, "Until the agency assesses how well community banks and credit unions understand [KBYO] requirements, CFPB may not be able to effectively respond to the risk that some smaller institutions have implemented [KBYO] incorrectly, unnecessarily burdening their staff and delaying consumers' home purchases."

The report also made nine other recommendations, including:

- The CFPB should issue public information on plans for reviewing regulations, including information on reviews of regulations and coordinate them with other federal depository institution regulators

Prepaid Accounts Rule

On January 25, 2018, the CFPB finalized changes to its Prepaid Accounts Rule. Most importantly, the rule's overall effective date has been extended one year, from April 1, 2018 to April 1, 2019. Initially, the effective date for some portions of the rule was October 1, 2017, but that was extended in April 2017 to the April 1, 2018 date.

Another major change announced in the final rule dealt with credit card accounts linked to prepaid accounts. The rule now includes a limited exception for certain dealings between business partners issuing prepaid accounts, prepaid credit cards and traditional credit cards. Specifically, the final rule cites "complications in applying the credit provisions of the Prepaid Accounts Rule to credit card accounts linked to digital wallets that can store funds where the credit card accounts are already subject to Regulation Z's (TILA) open-end credit card rules in circumstances that appear to pose lower risks to consumers." The exclusion only applies to credit card accounts that are linked to prepaid accounts, and an issuer must meet certain conditions to qualify, including that the parties:

- cannot allow the prepaid card to access credit from the credit card account in the course of a transaction with the prepaid card unless the consumer has submitted a written request that is separately signed or initialized, authorizing linking the two accounts;
- cannot condition the acquisition or retention of either account on whether the consumer authorizes such a linkage; and
- do not vary certain terms and conditions based on whether the two accounts are linked.

Another change in the final rule deals with prepaid accounts with negative balances. The new rule allows a prepaid issuer to qualify for an exception "with respect to the negative balance even if a covered separate credit feature offered by a business partner is attached to the prepaid account" as long as the three conditions laid out in the rule are met. These three conditions deal with access to credit features, issuers' policies and procedures and whether an issuer charges credit-related fees.

The final rule also addresses error resolution requirements. The rule incentivizes consumers to register their prepaid cards by not requiring financial institutions to limit liability or resolve errors until a prepaid account has completed its consumer identification and verification process.

Home Mortgage Disclosure Act

On December 21, the CFPB issued a statement on Regulation C (Home Mortgage Disclosure Act (HMDA)) implementation and focused on two areas: penalties and reconsidering aspects of the rule. Beginning January 2018, financial institutions must now collect and report additional mortgage information under Regulation C. The CFPB announced the amended HMDA Final Rule in 2015, but in 2017 released a number of smaller changes, including correcting technical errors, clarifying certain reporting requirements, and increasing the reporting threshold for home equity lines of credit (HELOCs) for two years.

In the new statement, the CFPB says it "does not intend to require financial institutions to resubmit data unless data errors are material, or to pay penalties with respect to data errors" for data collected in 2018 and reported in 2019. The CFPB wants financial institutions to use the 2018 HMDA data collection and submission process as an opportunity to discover gaps in their HMDA implementation and figure out what positive changes they can make for the future. Further, the CFPB expects that "any supervisory examinations of 2018 HMDA data will be diagnostic, to help institutions identify compliance weaknesses, and will credit good-faith compliance efforts."

While financial institutions view this as positive, the CFPB's statement reinforces the importance of making a good faith effort at compliance, conducting quality control and working to understand the gaps that exist in an institution's HMDA implementation.

Additionally, the announcement details how the CFPB may reconsider various aspects of the rule, including the institutional and transactional coverage tests. For example, the new rulemaking may re-evaluate the lending-activity criteria for mortgage data reporting. Another area that could be re-evaluated is the rule's discretionary data points. While Dodd-Frank specifically requires some of the new data points, the rulemaking could evaluate other data points that the CFPB included in amendments to Regulation C. ❖

YOUR CUSTOMER'S CUSTOMER IS ~~NOT~~ sometimes YOUR CUSTOMER

WHAT 'DERISKING' MEANS TODAY

The web of potential clients for financial institutions is expanding in an increasingly connected world. It has become critical for institutions to focus on the intersections of this web, and ensure an understanding of not only who immediate customers are, but also who these immediate customers serve. This idea of a "customer's customer" has spurred conversations at many institutions, but as regulators and legislators continue to focus more on the issue of derisking, institutions struggle to find a solution to this dilemma.

Defining "Derisking"

Recently, the term "derisking" has become prevalent within the financial services industry as a way to describe the trend of financial institutions' efforts to simplify business practices and reduce Bank Secrecy Act (BSA)/anti-money laundering (AML) risks by terminating certain products or relationships. An increase in both amount and frequency of enforcement actions imposed on banks for AML and sanctions violations has driven banks to become more alert and careful, and many banks have been exiting sectors that pose a high level of risk compared to potential returns, such as relationships with foreign correspondent banks (FCBs).

The Government Accountability Office (GAO), released a report on the subject in late February 2018, and defined "derisking" as "the practice of banks limiting certain services or ending their relationships with customers to, among other things, avoid perceived regulatory concerns about facilitating money laundering."

Why Banks Derisk

Financial institutions face substantial corporate and money laundering risks in their relationships with correspondent banks, and the regulatory consequences for oversights and missteps can therefore be severe.

- In January 2018, the Office of the Comptroller of the Currency announced it was charging a large bank with a $70 million civil money penalty for failing to comply with a 2012 order from the agency. Among the AML-related shortcomings were "weaknesses in controls related to correspondent banking," or, in other words, insufficient derisking.
- In November 2017, the Financial Crimes Enforcement Network (FinCEN) issued a $2 million penalty against a Texas-based bank for allowing $260 million to flow through its correspondent banking account with another bank headquartered in Mexico in less than two years, and without adequate scrutiny.

For many institutions, cutting ties with FCBs in higher-risk areas seems like a simple way to fix this problem, but regulators have begun to speak out against the practice of cutting ties when it is unnecessary, as derisking does not come without consequences.

Legislation and Guidance

Certain U.S. legislation requires financial institutions to mitigate risk in such ways as to provide controls for "knowing your customer's customer." Under the USA PATRIOT Act Section 312, for example, banks must properly gauge the risks of correspondent banking connections and, when warranted, execute enhanced due diligence (EDD) procedures.

In FinCEN's press release about their $2 million November penalty, then-Acting Director Jamal El-Hindi emphasized the importance for institutions of all sizes in following these standards: "Smaller banks, just like the bigger ones, need to fully understand and follow the 312 due diligence requirements if they open up accounts for foreign banks," he said. "The risks can indeed be managed, but not if they are ignored."

In October 2016, OCC issued guidance regarding managing the risks related to FCBs. This guidance outlined corporate governance best practices for periodic risk evaluations and account retention or termination. This guidance also reinforced the OCC's expectation that banks must establish policies and procedures for conducting risk assessments for FCBs, and that periodic evaluation and reassessment is an aspect of banks' ongoing risk management and due diligence obligations. The guidance outlined best practices including:

- Establishing and maintaining an effective governance function to review the method for periodic risk reevaluation and to monitor the appropriateness of recommendations regarding foreign correspondent account retention or termination.
- Communicating foreign correspondent account termination decisions regularly to senior management, with consideration given to the extent to which account closures may have an adverse impact on access to financial services for an entire group of customers or potential customers, or an entire geographic location.
- Communicating with foreign financial institutions, considering specific mitigating information these institutions may provide, and providing them sufficient time to establish alternative banking relationships before terminating accounts, unless doing so would be contrary to law, or pose an additional risk to the bank or national security, or reveal law enforcement activity.
- Ensuring a clear audit trail of the reasons and method used for account closure.

The Downsides of Derisking

When multiple institutions decide an area is "higher risk," it can lead to mass-exiting of particular areas or client types, and this can have profound and detrimental effects on foreign lenders and their customers.

Impeding Economic Growth

Most recently, a report from the GAO in February 2018 assessed the impact of derisking on access to financial services along the U.S. Southwest border. The agency said it conducted a survey after Southwest border residents and businesses reported difficulties accessing banking services in the region; those submitting complaints asked the agency to research whether these access limitations were the results of derisking and branch closures.

The report found that:

- Institutions in the region filed suspicious activity reports at two and a half times the rate of high-risk counties outside the region, on average.
- Eighty percent of banks in the region terminated accounts due to risks related to BSA/AML.
- Eighty percent of banks limited or did not offer accounts to certain businesses considered "high risk for money laundering and terrorist financing" because those customers attracted increased BSA/AML regulatory oversight.
- Money laundering risks were a more common and substantial catalyst for branch closures in the region than elsewhere.

GAO concluded that in the region, some account terminations and limitations, such as denying accounts to money service businesses and closing branches, have raised the likelihood that Southwest border communities will suffer from reduced economic growth and lack of access to banking services.

Driving Payments Underground

Exiting less-lucrative or higher-risk relationships with smaller FCBs makes sending and receiving international payments more difficult, and can lead to the exclusion of entire regions from global trade. This not only jeopardizes these countries' financial stability and growth, but also, according to the Basel Committee on Banking Supervision (BCBS), can drive payment flows underground into unregulated shadow markets.

On February 15, 2018, the House Financial Services Committee held a hearing titled "Examining De-risking and its Effect on Access to Financial Services." As part of the hearing opening statement, Rep. Blaine Luetkemeyer (R-MI) said "Removing the risk from the system actually creates a problematic environment where entire industries that were once part of a highly regulated system are pushed into the shadows."

Complicating Funds for Those in Need

FCB derisking is also an issue for many non-profit organizations that require funds transfers: Charity and Security Network published a report in February 2017 that showed derisking had impeded lifesaving assistance during humanitarian crises. The people of these regions are affected in a variety of ways: a parent who needs to send funds for a child's medical fees or a relative trying to wire money to a student may be unable to do so. Furthermore, the illegitimate and less-regulated methods of money transfer that individuals are forced to utilize can lead to even greater risks for those involved and can actually increase AML risk.

Government Focus on Derisking

In light of some of these concerns, regulators have begun to ask that financial institutions avoid cutting ties with foreign countries unless government officials have confirmed concrete cause for concern, and send out notice in the form of a sanctions list addition or otherwise. Accordingly, in February 2017, the OCC sent a memorandum to examiners explaining these problems with the practice of derisking. And in July 2017, the House Financial Services Committee held a hearing entitled "Managing Terrorism Financing Risk in Remittances and Money Transfers," to discuss some of the top concerns for legislators from the perspective of industry leaders in the field.

In the February derisking hearing, Luetkemeyer commented on the regulatory pressures institutions face and how these pressures serve as a catalyst for derisking: "I've heard too many people who have lost access to financial services… Across the financial spectrum, this dangerous trend of derisking is alive and well. Most likely, it's a result of increased exam pressure and compliance costs. Banks and credit unions are continuing to close accounts of long-standing customers, in some cases, even disclosing in writing that the regulatory pressure what simply too intense and the hurdles too insurmountable." The hearing's witnesses discussed suggestions for how regulators and legislators might attempt to fix this issue.

For example, Jason Oxman, chief executive officer of The Electronic Transactions Association, stated that he believes the best way to combat derisking is for law enforcement and regulators to "pursue the actual fraudsters" rather than the "service providers that provide millions of Americans — merchants, consumers, charities, nonprofits — access to payment systems." Oxman discussed H.R. 2706 (Financial Institution Customer Protection Act of 2017), which passed House in December 2017, as a potential solution to the problem. Bryan Schneider, secretary at the Illinois Department of Financial & Professional Regulation, and on behalf of the Conference of State Bank Supervisors (CSBS) discussed the tools regulators can provide to financial institutions for better self assessments and that "one pathway forward is data." He claimed that though "it doesn't in and of itself solve the problem… it provides a basis for being thoughtful about this, rather than just operating from conjecture and speculation."

GAO Recommends Further Action from Regulators

In the GAO's February report, the agency noted that despite producing some guidance on the subject, regulators have not been proactive in learning how banks' regulatory concerns and BSA/AML compliance efforts may be influencing dangerous derisking or branch closures. The report recommends that FinCEN, Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB) and the OCC should jointly conduct a "retrospective review" of BSA/AML regulations, including how banks implement these regulations. The review should focus on determining the bearing banks' regulatory concerns have on the banks' willingness to provide services. The GAO suggests that these agencies then use their findings to revise BSA regulations, ensuring efficiency and burden-mitigation, while disincentivizing detrimental derisking.

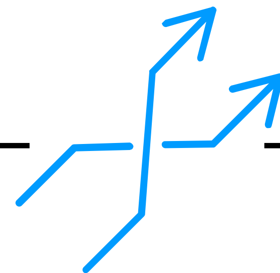
A Potential Shift Away from Enforcement Actions

The issues derisking poses venture into fair lending territory: if a financial institution makes the decision to not lend in certain areas, or not offer certain financial products or services, it is critical to ensure there are no CRA or fair lending violations that stem from this choice. A recent focus on redlining mitigation, coupled with a shift many regulators are making toward pre-enforcement analysis driven by consumer complaint, places a strong emphasis on fair lending implications. Acting Director of the CFPB Mick Mulvaney recently announced that the Office of Fair Lending and Equal Opportunity is moving from the Division of Supervision, Enforcement, and Fair Lending to the Office of Equal Opportunity and Fairness. While supervision and enforcement responsibilities will remain with the division, the Office of Fair Lending and Equal Opportunity plans to focus on advocacy, coordination and education.

The new Comptroller of the Currency Joseph Otting has emphasized banks' criticality in capital access and economic growth; he has supported bank small-dollar lending, but he also has expressed concern over shrinking branch networks (as the GAO study found in the Southwest Border region) and the possible effects these trends hold for minorities and lower-income communities.

Keeping Up-to-date

As the consequences of exiting certain markets, products or services becomes more evident, and as regulators begin to take note of mass-exiting, we are sure to see further developments in the field. An institution that hopes to not only comply with requirements, but also enhance the communities the institution serves, and therefore their own business, will want to stay abreast of these changes. Capco CRI will keep you updated as these shifts transpire.



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