Chapman and Cutler LLP

To the Point!

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FinCEN Proposed Rule on Customer Due Diligence Requirements

FinCEN recently published a Notice of Proposed Rulemaking regarding customer due diligence requirements for financial institutions (the *"Proposed Rule"*). In addition to clarifying existing due diligence requirements under the BSA/AML regulations, the Proposed Rule would categorically require covered financial institutions to identify and verify the beneficial owners of legal entity customers instead of taking the current risk-based approach.

FinCEN identifies several reasons for the Proposed Rule, including the exploitation of legal entities to conceal illicit financial activities and the disparate customer due diligence standards among covered financial institutions under the current risk-based approach. FinCEN also noted the potential for inconsistent regulatory examinations due to unclear customer due diligence standards.

The Proposed Rule introduces a two-prong definition of "beneficial owner" which includes (i) each person who directly or indirectly owns 25% or more of the equity interests of the legal entity and (ii) one person who has significant responsibility to control, manage or direct a legal entity (e.g., executive officer or senior manager). FinCEN proposed a standard certification form which would be filled out by the individual opening the account on behalf of the legal entity to identify the beneficial owners. Where a legal entity is owned by or controlled through one or more other legal entities, FinCEN would require the individual opening the account on its behalf to look through those other legal entities to determine who owns 25% or more of the equity interests. However, the requirement would only apply to corporations, LLCs and partnerships, excluding accounts opened by trusts.

It is important to note that financial institutions would not be required to verify that the individuals identified *actually* are the beneficial owners of the legal entity; they only have to verify the identities of the beneficial owners listed on the certification form. This verification must be conducted in accordance with the existing customer identification program (*"CIP"*) procedures set forth in the BSA/AML regulations.

If enacted, the Proposed Rule would apply to all banks, securities broker/dealers, mutual funds, futures commission merchants and introducing brokers in commodities, and would require a significant change in account opening procedures for legal entity customers. FinCEN has not provided any indication of when the Proposed Rule will be finalized, but FinCEN expects financial institutions will have one year to implement new measures once final rules are issued. As FinCEN has already conducted significant outreach and modified its proposal based on feedback from the industry following its ANPR, the Proposed Rule may be enacted without significant changes and financial institutions are encouraged to become familiar with its requirements and plan resources accordingly.

CFPB Issues First Enforcement Action for Mortgage Servicing Rules

The CFPB recently issued an enforcement action against a bank for unfair, deceptive or abusive acts or practices (*"UDAAP"*) and violating the CFPB's new mortgage servicing rules related to loss mitigation programs (the *"Servicing Rules"*). The total penalties of $37.5 million include $27.5 million in damages for mortgage loan borrowers and a $10 million civil money penalty. Under the same consent order with the CFPB, the bank is further restricted from acquiring additional default loan servicing rights and must conduct an independent review of its compliance system and implement a subsequent compliance plan.

The CFPB identified failures by the bank throughout the loss mitigation process over a time period from 2011 to the present. The CFPB found that the bank closed borrower applications for loss mitigation programs due to its own delays, delayed approving or denying loss mitigation program applications, failed or was delayed in notifying borrowers about incomplete applications, routinely miscalculated incomes, denied applications without providing a specific reason, failed to notify borrowers of their appeal rights, and prolonged trial periods for loan modifications, thus jeopardizing the borrower's ability to enter into a permanent loan modification.

It is interesting to note that the CFPB took action with respect to the bank's activities that preceded the January 10, 2014 effective date of the Servicing Rules as well as its activities after that date. The CFPB utilized its UDAAP authority to apply some of the new mortgage Servicing Rules to activities that occurred prior to the effective date. This hybrid enforcement action signals not only that the CFPB has begun taking action based on the new Servicing Rules, but that its scope is not limited to examinations related to the last nine months. We remind mortgage servicers and financial institutions that service their own mortgage loans to ensure their practices are in compliance with the Servicing Rules as of the effective date of January 10, 2014 and also to be prepared to provide support to demonstrate continuous good practices in the areas related to mortgage servicing prior to that effective date.

Cordray Speaks about Checking Account Issues

CFPB Director Richard Cordray spoke at a forum on checking accounts in Washington, D.C. on October 8, 2014. Director Cordray's remarks focused on how consumers' access to checking accounts may be unfairly affected by account opening screening policies and practices, specifically on how databases of specialty consumer reporting agencies servicing the checking account market are utilized. He defined the specialty consumer reporting agencies as those that report past negative checking account history, such as NSF activity, overdrafts, involuntary closures and fraud.

Director Cordray described three areas of concern related to these types of specialty consumer reports:

- Accuracy of the information contained in these reports may be negatively affected by inconsistencies caused by financial institutions' differing practices handling and reporting negative account information;
- Consumers' ability to access these reports and dispute any incorrect information and the lack of awareness of how the screening system affects their ability to open a checking account; and
- These reports are used like credit reports by financial institutions to assess credit risk, but instead result in denying basic financial services access for consumers.

Based on the concerns raised, the CFPB plans on exploring:

- Whether better data may enable financial institutions to make more nuanced decisions in account screening rather than a simple acceptance or denial;

- How consumers receive information about their right to obtain copies of their consumer reports from specialty consumer reporting agencies, the extent to which these rights are exercised, and how consumers receive information about their right to dispute information and the exercise of those dispute rights; and

- How the screening system could be used to better meet the needs of consumers rather than exclude them from the banking system.

While Director Cordray's remarks on access to checking accounts and the role specialty consumer reports play are not likely to make it to the rulemaking agenda of the CFPB in the near future, they certainly highlight a specific area of regulatory concern that the CFPB is actively exploring and is interested in. As the CFPB reaches out to gather information, we encourage financial institutions to review their account screening policies and procedures and the usage of specialty consumer reports in light of the concerns and questions raised. Engaging in such a proactive review will better prepare financial institutions to participate in dialogue with the CFPB to shape possible future guidance or regulations that balance the interests of financial institutions and consumers.

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To the Point! is a summary of items of interest and current issues for financial institutions with primary focus on regulatory, consumer, and corporate issues. Chapman and Cutler LLP maintains a dedicated practice group with the experience to counsel on these issues and other enterprise risk management matters facing financial institutions. If you would like to discuss any of the items contained in these briefings or other legal, regulatory, or compliance issues facing your institution, please contact one of the partners in our Bank Regulatory Group:

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