Anytown Financial Institution

Junior Case
Week 1

Subject Area:
Compliance Management

Case Leader: Jeanne Applegate

2019 Session
2019 COMPLIANCE MANAGEMENT CASE STUDY

In this case study, you are a member of the Executive Committee for Anytown Financial Institution. The committee is comprised of:

- President/CEO
- Chief Risk Officer
- Chief Financial Officer
- Chief Operations Officer
- Chief Lending Officer

[Assign Roles and Insert Names]

Anytown Financial Institution is a $325 million dollar bank with 40 employees. It has recently undergone Consumer Compliance, CRA and BSA Examinations. The attached Report of Examination from Anytown’s federal regulator describes examination findings. The Executive Committee has been asked to prepare a response to the Report of Examination that includes an action plan of what will be done to correct problems and prevent recurrence.

The Board is not happy because exam findings are not good. You are to recommend appropriate steps to fix the problems described in the exam report and put in place a compliance management system that effectively considers the three lines of defense: 1st line = business line management; 2nd line = compliance management; and 3rd line = audit program.

Your presentation should be no longer than 20 minutes. Expect questions from the Board (the audience) and bank legal counsel (the instructor). To assist you in your presentation, Anytown’s compliance officer and others have prepared memos on some of the various regulatory issues and concerns. You must consider these memoranda in preparing your final recommendations to the Board. You should know that Board members have copies of these memos. It’s advisable to disagree or at least effectively challenge the advice contained in the memos before making final recommendations to the Board.

When your committee presents its findings to the Board, you will:
- Tell the Board members of who you are by name and title
- Describe the major issues (see the Master Worksheet)
- Go into the detail about the issues (see the Detail Worksheet)
- Answer all questions Board members may ask related to your proposed action plan

If a necessary fact is missing from the Report of Examination or supporting memoranda, make an assumption regarding the fact and include such assumptions in your report. For example, it may be necessary to make assumptions about facts not specifically included in the memoranda, when estimating costs to correct identified problems, etc.

Acceptable solutions do not primarily rely solely on outside consultants, focus heavily on training or ignore cost considerations.
### DETAIL WORKSHEET #1

#### Describe Violation and Criticism

(Blank space for description)

#### Penalties or risks to bank (Check all applicable)

- Customer lawsuits
- Civil Money Penalties
- Agency Ordered Reimbursement
- Other

- Board Resolution
- Formal Agreement
- Enforcement Action

#### Corrective action(s)
(What you are going to do immediately to correct the problem)

1. __________________________
2. __________________________
3. __________________________
4. __________________________

#### Internal controls to prevent recurrence (What you are going to do to prevent recurrence)

1. __________________________
2. __________________________
3. __________________________
4. __________________________

#### Projected costs

(Blank space for costs)

#### Recommendations:

(Blank space for recommendations)
**DETAIL WORKSHEET #2**

**Describe Violation and Criticism**

---

**Penalties or risks to bank**  
*(Check all applicable)*

- [ ] Customer lawsuits
- [ ] Civil Money Penalties
- [ ] Agency Ordered Reimbursement
- [ ] Other ________________

- [ ] Board Resolution
- [ ] Formal Agreement
- [ ] Enforcement Action

**Corrective action(s)**  
*(What you are going to do immediately to correct the problem)*

1. ________________
2. ________________
3. ________________
4. ________________

**Internal controls to prevent recurrence**  
*(What you are going to do to prevent recurrence)*

1. ________________
2. ________________
3. ________________
4. ________________

**Projected costs**

---

**Recommendations:**

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**DETAILED WORKSHEET #3**

**Describe Violation and Criticism**

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**The “not” statement**

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**Penalties or risks to bank**

*(Check all applicable)*

- Customer lawsuits
- Civil Money Penalties
- Agency Ordered Reimbursement
- Other

---

**Corrective action(s)**

*(What you are going to do immediately to correct the problem)*

1. ____________________
2. ____________________
3. ____________________
4. ____________________

---

**Internal controls to prevent recurrence**

*(What you are going to do to prevent recurrence)*

1. ____________________
2. ____________________
3. ____________________
4. ____________________

---

**Projected costs**

---

**Recommendations:**

---
<table>
<thead>
<tr>
<th>Summarize the problem areas assigned to your group. For example, what is the violation, how did the violation occur, who is responsible, is it a systemic or isolated issue, etc.? <strong>Treat the problem...not the symptom.</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
</tr>
<tr>
<td>2.</td>
</tr>
<tr>
<td>3.</td>
</tr>
<tr>
<td>4.</td>
</tr>
<tr>
<td>5.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Describe which problems should be addressed first and why; use a risk-based approach; speak to legal, transaction, reputation, and/or operational risks:</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Prioritize any remaining issues and actions that should be taken (e.g., staffing levels and competency, board/management oversight, questionable director/3rd party vendor management, etc.):</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>How much will it cost to mitigate risks, violations, etc.?</th>
</tr>
</thead>
</table>
EXAMPLES - CONTROL TOOLS – NOT ALL INCLUSIVE

PREVENTIVE – attempts to stop undesirable events before they occur

- Automated processes/routines
- Network restrictions and access controls
- Physical restrictions
- Standard defaults on forms, in systems, etc.
- Authorization / approval procedures
- Centralized functions
- Control points or processing limitations
- Integrated quality assurance process (input/process focus)

DETECTIVE – timely detection of undesirable events after they occur

- Exception reports
- File reviews
- Segregated quality control reviews (output/results focus)
- Reconciliations / balancing
- Rotation of duties
- Mandatory PTO (e.g., time away from current job with ZERO contact)
- Complaint management
- KRI trending

DIRECTIVE – encouraging desirable events to occur

- Strategic planning and goals
- Policy and governance surrounding them
- Written procedures/manuals
- Standardized forms
- Training

MONITORING – supervising, observing, and testing activities that monitor performance of control activities

- Monitoring reports
- Checklists
- Compliance reviews
- Audits
- Regulatory examinations
FEDERAL EXAMINATION AND REGULATORY CORPORATION

Compliance, Bank Secrecy Act, and CRA Examination
Certificate Number: 2693452

BANK OF ANYTOWN

Examiner-In-Charge ___________ Candice B. Fureal ___________ Close of Business _______ April 1, 2019 _______

COMPLIANCE REPORT

THIS REPORT IS STRICTLY CONFIDENTIAL

This report has been made by an examiner appointed by the Board of Directors of the FEAR Co. for use in the fair and balanced supervision of this financial institution. The information contained in this report is based upon the books and records of the financial institution, statements made by directors or trustees, officers, and employees, and information obtained from other sources believed to be reliable such as Facebook and Twitter.

Each director or trustee, in accordance with his or her responsibilities to depositors, and to shareholders as applicable, should thoroughly review the contents of this report and, based on the findings and recommendations of the supreme examiner, take whatever action may be necessary to ensure the financial institution is operated in a safe and sound manner in compliance with the applicable requirements of law and regulation.

This report is the property of the FEAR Co. and is furnished to the financial institution for its confidential use. Under no circumstances should the financial institution or any of its directors or trustees, officers, or employees disclose or make public in any manner this report or any portion thereof. Inappropriate disclosure of the contents of this report will result in penalties and fines, and maybe even jail time depending on the mood of the instructor. If a subpoena or other legal process is received calling for production of this report or any part of it, the Regional Office of the FEAR Co. should be notified immediately. The attorney at whose instance the process was issued and, if necessary, the court that issued it should be advised of these restrictions and referred to the appropriate statutory restrictions on its public disclosure.

FEDERAL EXAMINATION AND REGULATORY CORPORATION
EXAM CONCLUSIONS AND COMMENTS

SCOPE OF EXAMINATION

Consumer Compliance, Bank Secrecy Act and Community Reinvestment Act examinations were performed using procedures found in the FEAR Exam Handbook. The objectives of the examinations were to determine adequacy of compliance management systems including compliance with lending and deposit related rules, and an assessment of fair lending practices. The institution’s compliance with the Flood Disaster Protection Act was reviewed and compliance with the Bank Secrecy Act and USA PATRIOT Act was reviewed using the FFIEC’s BSA Examination Procedures. CRA performance was assessed using FFIEC exam procedures.

SUMMARY OF VIOLATIONS

Truth-in-Lending - Reimbursable Violations
Detailed in this report are reimbursable violations of Consumer Financial Protection Bureau’s (“CFPB”) Regulation Z - Truth-in-Lending Act regulation in re under-stated APR’s on real estate loans.

High Significance and Other Violations
Violations of the CFPB’s Regulation B - Equal Credit Opportunity involving disparate treatment with regard to information requirements, spousal signatures and required cosigners were noted, as were other violations involving Regulation E, Real Estate Settlement Procedures and Flood Disaster Protection. Furthermore, certain practices relative to Regulation CC holds and subsequent overdraft fees could be considered an abusive act or practice under UDAAP1 principles. Also of concern are the super serious weaknesses and violations identified regarding the Bank Secrecy Act compliance program. Attention is directed to the list of Apparent Violations for further comment on these and other violations.

MATTERS REQUIRING IMMEDIATE ATTENTION

Insufficient Supervision by the Board of Directors
The Board has not responded adequately to previously identified compliance deficiencies. As a result, the compliance management program is deemed less than satisfactory. The Board’s failure to establish and implement an effective Compliance Management System has resulted in numerous violations, some of which are substantive in nature. This is the second consecutive examination in which serious compliance deficiencies were noted.

The compliance program has not been implemented. Further, it is evident that bank management has relied on regulators to guide personnel and identify deficiencies. This passive posture and failure to effectively administer the bank’s compliance management system has ultimately resulted in a downgrade in the Bank of Anytown’s Consumer Compliance Rating.

The compliance management is the Board’s responsibility. It is imperative the Board take prompt corrective action to ensure implementation of the compliance program, a training program is implemented to educate personnel, a BSA Compliance Officer is appointed to oversee BSA compliance responsibilities, and all individuals responsible for compliance-related duties are provided sufficient training to carry out such responsibilities.

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1 Unfair, Deceptive, or Abusive Acts or Practices

LSU Graduate School of Banking 2019 B-2 FEAR Report of Examination
Compliance Management System
Board and management oversight of the Compliance Management System (CMS) is deficient. Compliance resources and staff are inadequate to ensure the financial institution is in compliance with consumer laws and regulations. Training and review procedures are lacking, as evidenced by the repeat and varied violations detailed in this report. Specifically, loan disclosures are primarily prepared by two individuals who have received only minimal instruction and whose work is not periodically checked or verified. Real estate loan packets are not reviewed prior to closing to ensure compliance with the requirements of the Truth-in-Lending Act (i.e., Regulation Z), Real Estate Settlement Procedures Act, and Flood Insurance rules. Overall, loan files are a hot mess.

An effective CMS must be implemented that includes internal controls and adequate review procedures. Personnel need to be trained to ensure current working knowledge of the various laws and regulations affecting work areas. Verification procedures must also be instituted to ensure that existing practices are consistent with policy and regulatory requirements. Finally, a complaint management program should be established as an early warning system in the identification of program deficiencies.

Bank Secrecy Act
The Bank Secrecy Act compliance program is a train wreck. Management has not performed a Bank Secrecy Act (BSA) / Anti-Money Laundering (AML) risk assessment, failed to adequately implement Customer Identification Program (CIP) or Beneficial Ownership requirements, or establish meaningful suspicious activity monitoring processes. Internal controls are limited at best, and a BSA officer has not been appointed. Independent testing and employee training weaknesses were also noted. Furthermore, management has not updated the bank’s Office of Foreign Assets Control (OFAC) risk assessment and there appears to be significant OFAC and other BSA-related risk exposure because of the bank’s relationships with the American South Cannabis Growers League and the Hemp! Hemp! Huray Farmers & Export Group.

Two violations are included in this section of the report related to the inappropriate retention of customer identification documents and images; these violations must be corrected pronto.

COMMUNITY REINVESTMENT ACT
Anytown’s Community Reinvestment Act (CRA) performance has been less than adequate. Analysis of the geographic distribution of the loan portfolio revealed few credit extensions in low- and moderate-income neighborhoods, nothing to write home about. Management is considering closing a branch office in a moderate-income neighborhood, yet no meaningful analysis has taken place to determine the impact of this branch closure on the residents in the area beyond identifying the branch’s low profits.

FEAR examiners identified four complaints from community members related to the bank’s low volume of lending in low- and moderate-income (LMI) neighborhoods (including one alleging marital status discrimination); however, said complaints were not found in the CRA Public File or provided to the Board. The Board must take steps immediately to improve performance consistent with safe and sound banking practices, as well as ensure the CRA Public File is current. Furthermore, it is recommended the institution undertake more meaningful analysis relative to the closing of the Riverside Branch and whether there are alternative means of serving the community.

The Board is advised that future branch expansions have a snowball’s chance if CRA concerns are not corrected.
BOARD MEETING

A special meeting of the Board of Directors was held on May 10, 2019. All members of the Board were present. FEAR Examiners Candice B. Fureal and Darrell B. Moore represented FEAR.

Insufficient board and management oversight, violations of law, non-compliance with the Bank Secrecy Act, CRA Performance Evaluation findings and recommended corrective actions were discussed. Examiner-In-Charge Fureal explained that due to the super seriousness of violations noted, the Board should not act surprised or throw a fit if they receive an enforcement action, formal agreement, and/or civil money penalties from HQ (aka the Washington D.C. Office of FEAR.) Furthermore, HQ may determine the consumer compliance rating of “3” is too generous and downgrade the rating to “4”.

Board members unanimously passed Resolution E1E10 to correct violations immediately and provide resources to strengthen the Compliance, CRA and BSA Programs.

RATINGS

The subject financial institution has been assigned a consumer compliance rating of “3”. This rating reflects a Compliance Management System deficient at managing consumer compliance risk in institution’s products and services and at limiting violations of law and consumer harm.\(^2\)

The financial institution’s performance under the Community Reinvestment Act has been rated “Needs to Improve Record of Meeting Community Credit Needs”. A financial institution in this group has a less than satisfactory record of helping to meeting community credit needs. The Board of Directors and management have not placed strong enough emphasis on the credit needs of the community and the financial institution is encouraged to improve its record of helping to meet those needs by reviewing its record, noting the shortcomings cited in this report and proceeding accordingly.

The Board is advised that compliance weaknesses in re the Bank Secrecy Act, USA PATRIOT Act and OFAC may adversely affect one or more components of its CAMELS rating. Said determination(s) will be made by Regional Office and/or Washington D.C. officials.

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\(^2\) This rating is based on the FFIEC’s revised Uniform Interagency Consumer Compliance Rating System effective March 31, 2017. As a reminder, this rating is subject to Regional Office concurrence.
TRUTH IN LENDING (i.e., Regulation Z)

Reimbursable Violations – Closed-end Credit

Regulation Z requires the inclusion of loan fees, points, finder’s fees or similar charges in the finance charge disclosure.

Regulation Z requires that the annual percentage rate be accurately disclosed.

The Truth-in-Lending Act requires the regulatory agency to order creditors to make monetary adjustments to the accounts of consumers in cases where the finance charge has been understated by more than the allowed tolerance.

A review of various closed-end real estate loans made since the last exam revealed a number of Truth-in-Lending/Closing Disclosure statements containing understated annual percentage rates (APR) and finance charge disclosures. In those cases the appraisal fee charged by the appraiser ranged from $200 to $250; however, the financial institution increased all of these fees to $325 with the excess fee taken into income by the bank and not paid to the appraiser. Consequently, the bank failed to include the additional fee in the total amount of the finance charge and to consider it in the calculation of the annual percentage rate. A pattern has been established with the loans in which appraisal fees were assessed. The examiner sampled 25 of the estimated 500 real estate loans and found the increased appraisal fee in all cases.

Anytown will be required to make the appropriate calculated adjustment based on the greater of the understated annual percentage rate or the understated finance charge.

A file search is required to determine the number of affected loans. It should consist of all real estate loans in which an appraisal fee was assessed. In reference to paid out loans, adjustment will not be ordered if the violation occurred in a transaction consummated more than two years prior to the date of the current examination.

Additionally, the Regional Office is contemplating the UDAAP implications of this activity as it appears to be deceptive. If UDAAP violations cited, further remediation will be warranted.
VIOLATIONS OF LAWS AND REGULATIONS

Detailed below are apparent violations of applicable statute, regulation or policy statement. In each case, reference is made to the relevant provision(s) of statute, regulation or policy statement together with a brief description of the act or omission constituting the apparent violation.

TRUTH IN LENDING (continued)

The following is a representative sample of loans containing the above noted violations.

<table>
<thead>
<tr>
<th>Name</th>
<th>Date</th>
<th>Amount ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joe, Bob</td>
<td>05/12/YY</td>
<td>45,000</td>
</tr>
<tr>
<td>Jim, Bob</td>
<td>12/15/YY</td>
<td>63,525</td>
</tr>
<tr>
<td>Billy, Bob</td>
<td>03/26/YY</td>
<td>52,600</td>
</tr>
<tr>
<td>Mary, Bob</td>
<td>03/03/YY</td>
<td>77,000</td>
</tr>
</tbody>
</table>

Non-Reimbursable Violations – Closed-end Credit

Regulation Z requires the creditor to furnish each customer entitled to rescind with two copies of the notice on a separate document that identifies the transaction and clearly makes the disclosures required by this section.

Review of rescindable real estate transactions revealed loan officers are only providing one set of rescission notices to joint borrowers. Consequently, the financial institution is subject to significant compliance risk as rescission windows have not “closed” for approximately 40 loan customers.

EXPEDITED FUNDS AVAILABILITY

Regulation CC states that a depository bank shall make funds deposited in an account by check available for withdrawal not later than the business day after the banking day on which the funds are deposited the lesser of $200, or the aggregate amount deposited on any one banking day to all accounts of the customer by check or checks not subject to next-day availability.

Examiners identified 13 of 20 case-by-case holds in which funds were held for longer than two business days. Additionally, in 7 instances the first $200 of the deposits was not made available on the initial day of the deposit. Furthermore, comparison of the report of deposit holds provided by management along with the report of overdrafts caused by one-time POS transactions or ATM withdrawals indicated that the holds in place caused overdraft fees when funds should have been made available. The charging of fees for funds that should have been available may be considered an abusive act or practice under UDAAP.
VIOLATIONS OF LAWS AND REGULATIONS

Detailed below are apparent violations of applicable statute, regulation or policy statement. In each case, reference is made to the relevant provision(s) of statute, regulation or policy statement together with a brief description of the act or omission constituting the apparent violation.

EXPEDITED FUNDS AVAILABILITY (continued)

Regulation CC requires certain procedures for exceptions for return checks. Regulation CC requires that, when invoking a hold for an account, the bank must provide the customer with a notice containing certain information within prescribed time periods.

Discussion with bank personnel revealed the notices were not being sent when holds were placed on accounts due to notice of return checks or when holds were placed on deposits involving commercial deposit accounts.

ELECTRONIC FUND TRANSFERS

Regulation E provides that a financial institution may not charge overdraft fees for paying an ATM or one-time debit card transaction unless the consumer has been provided a written notice describing the overdraft service, a reasonable opportunity to affirmatively consent (opt-in), and the financial institution has obtained the consumer’s affirmative consent and mailed or delivered written confirmation of the consent, including a statement informing the consumer of the right to revoke consent.

The bank authorized and paid overdrafts for ATM withdrawals for customers who had not opted-in to the bank’s Bounce Protection program without providing them proper disclosure of their opt-in right prior to assessing overdraft fees in connection with said ATM withdrawals. In these instances, customers agreed to a “one-time” opt-in; however, the regulation does not differentiate between one-time or recurring opt-in selections. The bank is required to cease this practice immediately, which has been in effect since January 1, 2018. Additionally, the bank must identify all impacted customers and issue refunds for overdraft fees inappropriately assessed.

Regulation E provides that a financial institution may impose liability on a consumer for unauthorized transfers involving the consumer's account only if certain conditions are met, including providing a consumer with the long form error resolution notice at least once each calendar year or, alternatively, the short form notice on or with each periodic statement.

The bank relies on the “short form” Regulation E Error Resolution Notice to impose liability when permissible. However, the notice has not been included with electronic statements for approximately two years, which is when a new forms vendor was hired. As a result, customers receiving only electronic statements did not receive notice. Therefore, the bank cannot impose any liability on these customers for unauthorized transactions.
ELECTRONIC FUND TRANSFERS (continued)

Approximately 375 customers are impacted, with at least 40 disputes filed in which customers were held liable for $500. A look back of all disputes involving these 375 customers is required to identify customers harmed so that refunds can be made. Additionally, if any accounts were charged off directly or indirectly related to this activity, the bank must identify and correct any instances in which adverse information was reported to the credit bureau.

FLOOD DISASTER PROTECTION ACT

The Flood Disaster Protection Act (FDPA) requires financial institutions to exercise diligence in ensuring that loans secured with improved real estate are adequately covered by flood insurance if certain conditions are met. The regulation requires, in part, that institutions determine whether property is located in a special flood hazard area, record said determination on the Standard Flood Hazard Determination Form, and to obtain adequate flood insurance coverage if the property is located in a participating community.

A review of 5 loans secured with improved real estate revealed the following:

- In three instances personnel failed to record the flood determination on the required Standard Flood Hazard Determination Form. The determination had nonetheless been performed, but the document used to retain the information was not prescribed by law and did not contain all required information.

- Management failed to obtain flood insurance for one residential loan that was secured with improved/occupied real estate located in a special flood hazard area of a participating community. File records suggest the reason the insurance was not obtained was because the collateral was taken out of an abundance of caution.

Furthermore, management charges life-of-loan determination fees even when loans do not close (such as loan denials). This is a violation of the FDPA which stipulates that a borrower can be charged a specific fee for a flood determination when the determination is made or prompted: (1) in connection with the making, increasing, extending, or renewing of a loan; (2) by FEMA’s revision of floodplain areas or flood-risk zones; (3) by FEMA’s publication of notices that affect the area in which a security property is located; or (4) by force placement of insurance. Since the loans are not closed, none of the above criteria have been met and as a result, violations have occurred.
VIOLATIONS OF LAWS AND REGULATIONS

Detailed below are apparent violations of applicable statute, regulation or policy statement. In each case, reference is made to the relevant provision(s) of statute, regulation or policy statement together with a brief description of the act or omission constituting the apparent violation.

EQUAL CREDIT OPPORTUNITY

Regulation B prohibits the creditor from discriminating in any aspect of a credit transaction on the basis of sex.

Loan policy provisions require current financial statements and credit reports be obtained for all real estate related loans. Ten real estate loans were sampled of which five were to males and five were to females.

The sample revealed that three of the five males were not required to provide financial statements and credit reports in accordance with the written guidelines. However, all five females were required to provide financial statements and credit reports. Credit files did not document any basis for the exceptions granted to the male borrowers.

Discussion with lending officers indicated an unwritten policy to waive financial statements and credit reports if the customer has such information on file and it is not more than twelve months old.

The males who did not meet this unwritten policy requirement are listed below.

<table>
<thead>
<tr>
<th>Borrower</th>
<th>Loan Amount</th>
<th>Application Date</th>
<th>Exception</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pitt, B.</td>
<td>$215,000</td>
<td>11/06/XX</td>
<td>No FS/Credit Report</td>
</tr>
<tr>
<td>Clooney, G.</td>
<td>$215,000</td>
<td>04/01/XX</td>
<td>No FS</td>
</tr>
<tr>
<td>Washington, D.</td>
<td>$26,000</td>
<td>04/19/XX</td>
<td>No Credit Report</td>
</tr>
</tbody>
</table>
VIOLATIONS OF LAWS AND REGULATIONS

Detailed below are apparent violations of applicable statute, regulation or policy statement. In each case, reference is made to the relevant provision(s) of statute, regulation or policy statement together with a brief description of the act or omission constituting the apparent violation.

EQUAL CREDIT OPPORTUNITY (continued)

Regulation B prohibits the creditor from discriminating in any aspect of a credit transaction on the basis of age (providing that the applicant has the capacity to enter into a binding contract).

Regulation B prohibits the creditor from requiring the signature of an applicant’s spouse or other person (other than a joint applicant) on any credit instrument if the applicant qualifies under the Creditor’s Standards of Creditworthiness for the amount and term of the credit requested. It also prevents a creditor from requiring that the applicant’s spouse co-sign an obligation when the personal liability of a second individual is necessary to support the extension of credit requested.

A sampling of the bank’s installment loans revealed six instances in which the bank required cosigners of applicants who appeared to be otherwise qualified. In all six cases, the applicant was under the age of 25. Discussions with lending officers indicated it is the bank’s policy to require cosigners on borrowers under the age of 25, with preference being parental cosigners, because management believes delinquencies and charge-offs are significantly higher for customers between 18 and 25.

The following are examples of borrowers who were required to provide cosigners because they were between the ages of 18 and 25:

<table>
<thead>
<tr>
<th>Applicant</th>
<th>Date of Application</th>
<th>Loan Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Griffin, S.</td>
<td>11/09/YY</td>
<td>$6,500</td>
</tr>
<tr>
<td>Cartman, E.</td>
<td>11/15/YY</td>
<td>$12,000</td>
</tr>
<tr>
<td>Brady, M.</td>
<td>10/21/YY</td>
<td>$5,000</td>
</tr>
<tr>
<td>Robinson, W.</td>
<td>09/19/YY</td>
<td>$7,200</td>
</tr>
</tbody>
</table>

Another violation was noted involving spousal signatures on loans. Specifically, it is the policy of the senior loan officer at the main branch to require spousal signatures on the note when loans are made to closely held corporations or LLCs even when the spouse is not a principal of the company. When asked why, the officer stated it was his experience the only real collateral for such loans is usually the principal’s residence, so he has to have the spouse sign the note or guaranty so that he will be able to move against the house if the business loan fails. Five of five loans were noted to include spousal signatures in violation of Regulation B.
VIOLATIONS OF LAWS AND REGULATIONS

Detailed below are apparent violations of applicable statute, regulation or policy statement. In each case, reference is made to the relevant provision(s) of statute, regulation or policy statement together with a brief description of the act or omission constituting the apparent violation.

BANK SECRECY ACT

FinCEN’s 31 CFR Chapter X (i.e., the “Bank Secrecy Act”) requires, in part, financial institutions have a written compliance program:

(1) That provides for a system of internal controls to assure ongoing compliance;
(2) That provides for a system of independent testing for compliance by bank personnel or an outside party;
(3) Provides for the training of appropriate personnel; and
(4) Provides for the designation of an individual(s) to coordinate and monitor day-to-day compliance.

The BSA compliance program is deficient. The written program only repeats regulatory requirements, but nothing beyond that. For example, there are no comments or procedures describing internal controls, independent testing for compliance, or periodic employee training. Additionally, while the document does state a BSA Officer will be appointed, one has not been designated.

Other deficiencies include the failure to conduct a BSA/AML risk assessment, failure to implement CIP and Beneficial Ownership requirements, and OFAC processes that do not include monetary instruments sold to non-customers or PUPID wire transfers. In fact, the bank has significant OFAC exposure as searches are only completed at the time account relationships are established. Suspicious activity monitoring processes are sporadic at best, with no attention being given to managing risks associated with two new relationships: American South Cannabis Growers League and the Hemp! Hemp! Hurry Farmers & Export Group.

FinCEN’s 31 CFR Chapter X requires a bank to file a Currency Transaction Report for each applicable transaction exceeding $10,000 in cash not otherwise eligible for exemption.

Bank personnel failed to identify three reportable cash transactions conducted by or on behalf of the same person during the same business day. The cash withdrawals involved multiple transactions conducted by a local convenience store operating as a check cashing business. It was noted that there was no evidence available to suggest the customer has registered with FinCEN as a Money Service Business.

3 Payable upon proper ID
VIOLATIONS OF LAWS AND REGULATIONS

Detailed below are apparent violations of applicable statute, regulation or policy statement. In each case, reference is made to the relevant provision(s) of statute, regulation or policy statement together with a brief description of the act or omission constituting the apparent violation.

BANK SECRECY ACT (continued)

FinCEN’s 31 CFR Chapter X requires a bank to file a Suspicious Activity Report (SAR) if:

(1) The transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities;
(2) The transaction is designed to evade any regulations promulgated under the Bank Secrecy Act; or
(3) The transaction has no business or apparent lawful purpose, or is not the sort in which the particular customer would normally be expected to engage, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

Interviews with bank personnel, as well as review of customer transactions reveal the financial institution has not filed suspicious activity reports when obviously reportable cash structuring occurrences arise. For example, three accounts were identified where repeated structuring of cash transactions was noted, with one being a convenience store operating a private ATM.

ECONOMIC GROWTH, REGULATORY RELIEF AND CONSUMER PROTECTION ACT

Section 213 of S.2155, effective May 24, 2018, stipulates financial institutions must delete any copy or image of an individual’s driver’s license or personal identification card after use in verifying identity or other legal requirements if obtained electronically when an individual initiated an online request to open an account or obtain a financial product/service. Information from the artifact may be stored, but digital images must be deleted from the “cloud” once verification processes are complete.

The Home4Everyone mobile app captures driver’s license images for mortgage loan applicants; however, images are still being retained on the bank’s servers in violation of this rule.

TITLE 18, U.S.C. PART I, CHAPTER 33

Section 701 prohibits the copying, scanning or otherwise duplication of federal government employment or military identification. Information may be recorded, but duplication is prohibited.

CIP procedures specifically reference collection of military IDs and several instances were identified among the bank’s records in violation of this rule.
VIOLATIONS OF LAWS AND REGULATIONS

Detailed below are apparent violations of applicable statute, regulation or policy statement. In each case, reference is made to the relevant provision(s) of statute, regulation or policy statement together with a brief description of the act or omission constituting the apparent violation.

REAL ESTATE SETTLEMENT PROCEDURES ACT

RESPA prohibits acceptance of kickbacks and unearned fees as a part of a real estate settlement service.

It appears the increased charges on real estate appraisals constitute an unearned fee in violation of this section. As noted previously in the Truth In Lending violations, appraisal fees charged by the appraiser (a bank director) have ranged from $200 to $250; however, the financial institution increased these fees to $325 with the excess fee taken into income by the bank and not paid to the appraiser.

The following is a representative sample of loans containing the above noted violations.

<table>
<thead>
<tr>
<th>Borrower</th>
<th>Loan Amount</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nelson, W.</td>
<td>$73,200</td>
<td>02/10/YY</td>
</tr>
<tr>
<td>Strait, G.</td>
<td>$150,000</td>
<td>03/15/YY</td>
</tr>
<tr>
<td>Taylor, J.</td>
<td>$110,500</td>
<td>10/18/YY</td>
</tr>
</tbody>
</table>

Additionally, unearned fees for flood monitoring purposes were noted among applications for residential real estate loans that were not closed. Records for three of five denied or withdrawn applications reviewed included evidence that the applicants paid for the life-of-loan flood risk monitoring. However, since the loans were never consummated, the monitoring did not take place. Therefore, the fee is considered an “unearned fee” in violation of RESPA.

The following applications containing the above noted violations.

<table>
<thead>
<tr>
<th>Borrower</th>
<th>Loan Amount Requested</th>
<th>Application Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bach, J.S.</td>
<td>$87,000</td>
<td>08/10/YY</td>
</tr>
<tr>
<td>Chopin, F.</td>
<td>$349,000</td>
<td>01/15/YY</td>
</tr>
<tr>
<td>Von Beethoven, L.</td>
<td>$169,500</td>
<td>12/18/YY</td>
</tr>
</tbody>
</table>
COMMUNITY REINVESTMENT

REASONABLENESS OF DELINEATED COMMUNITY

Bank of Anytown is a $325 million institution with 40 employees. The bank has one office located in Anytown, Anystate and 2 branches in the county. The Bank of Anytown delineates as its local community the town of Anytown and Any County, Anystate. This delineation appears reasonable and does not arbitrarily exclude low- to moderate-income areas.

GEOGRAPHIC DISTRIBUTION OF LOANS

The geographic distribution of the institution’s credit extensions, credit applications and credit denials is questionable and seemingly fails the smell test.

The bank has no system for determining the geographic distribution of credit extension, applications, and denials. A review during the examination revealed that approximately 90 percent of the bank’s loans were within Any County; however, there appears to be some disparity in the distribution of loans within the community. Applications from the low- and moderate-income areas have a greater chance for denial and fewer applications are received in these areas.

It is recommended that management establish a formal method of determining the geographic distribution of the bank’s loan applications, extensions in credit denials. This information should be readily available to the directors and bank staff so that it could be reviewed to identify the potential development of disparate lending practices in a timely fashion.

In addition, this information could be used to established or revise loan policies, products and services, and branching opportunities.

EVIDENCE OF PROHIBITED OR DISCRIMINATORY OR OTHER ILLEGAL CREDIT PRACTICES

Evidence of disparate treatment of female and young applicants was noted. It appears loan officers were requiring cosigners and spousal signatures in violation of Regulation B, as well as applying more stringent documentation standards to female borrowers.

As a result of these findings, the bank’s CRA program has been assigned a NEEDS IMPROVEMENT rating.
Memorandum
To: Senior Loan Officer
From: Candy Barr, Administrative Assistant and Compliance Officer
Date: May 15, 2019
Subject: Fees Paid to Outside Service Providers

This is to advise you of my research on how we are handling appraisals on our real estate loans.

We direct borrowers to use Appraisals-2-Order, which is operated by Ted Roosevelt and his newest girlfriend Kimmi. This has been our practice since we purchased the company in 2017.

Ted is familiar with the high-end properties in our community. Additionally, he has agreed to an up charge on his services to $325 (the appraisals run $200 to $250). He sends the $75 to $125 excess back to us to cover our time and costs in preparing the preliminary information for the appraisal. He gets a tax break, too. Since he’s is a director, we thought this was okay.

We have also outsourced the flood hazard determination to him as well. Kimmi faxes a final determination of whether the property is in a flood zone within 24 hours of receipt of the property description. Again, Ted agreed to the $25 up charge (nominal in my opinion), which is being returned to the bank as compensation for preparing the initial information to allow him to do the flood determination. I think this was his idea on the flood determinations.

When the FEAR examiners were on site, they explained that we cannot receive a kickback of their fee (“kickback” is the examiners’ word; not mine). In my opinion, we should be able to increase the actual charges to cover our time and effort and if we stop, our income will go down.

I talked to the compliance officer at Possum Trot Bank about fees. She says they have the same arrangement as we do for up charges. They don’t consider it a kickback and have never been criticized for it.

I trust that you will find all of the above satisfactory. Please let me know if you have any questions.
Memorandum
To: Executive Committee
From: Candy Barr, Administrative Assistant and Compliance Officer
Date: May 14, 2019
Subject: Compliance Violations – Operations

Two memos are attached reflecting our experience with the European Autos’ account. This account was referenced by the examiners as an example of problems in the Operations area.

They explained that if we had a “Know Your Customer” policy in place we would have obtained more information when the account was opened. I am not sure what we could do except get a Dunn & Bradstreet or LexisNexis on the company. Examiners suggested something called “enhanced customer due diligence” activities and also said we would have to get info from them under the Beneficial Ownership rules if we do any more business with them. Any suggestions?

Additionally, the examiners said we should have sent notice to our customer when we put the hold on European Auto’s account. My understanding is we only send notices when we put holds on consumer accounts. I will prepare a memo to all tellers explaining the need to send notice of holds on commercial accounts, too.

As a side note, when we place holds on consumer accounts, we do give the customer the first $100 but it appears we are supposed to give $200. I’m not sure when this changed, but examiners tell me that we are holding these deposits too long, and that overdraft fees on any accounts with improper must be refunded asap.

I argued this point with the examiners, but they would not change their minds. I will await direction from you before issuing any refunds.
Memorandum

To: Executive Committee

From: Eugene Poole, Treasury Management & Private Banking Officer

Date: January 16, 2019

Subject: Account Relationship with European Autos, Inc.

This is to advise you we opened an account for the above company in June 2018. It has been a very profitable account for us in terms of fee income and referrals to other potential customers. European Autos, Inc. specializes in the sale of previously owned European luxury automobiles. They opened their dealership last year. They now have an inventory of approximately 10 late-model European luxury cars purchased from auction houses located in Europe and shipped to the United States aboard cargo vessels. Purchasers are mostly wealthy customers who want to maintain a high level of privacy. Therefore, the showroom is open by appointment only. I have not seen the cars personally, but given the amount of money moving through their account they are clearly successful.

They initially established a banking relationship with Whoosagoodboy Bank. However, they decided to move their business because the account officer at Whoosagoodboy did everything by the “book” and would not be flexible with their special needs. In fact, one of the most irritating things Whoosagoodboy did was insist on having information in their files regarding European Auto’s purchasing activities in Europe. Further, the owner of the business is going through a difficult divorce from his third wife Kimmi and Whoosagoodboy Bank was not very sympathetic when it came to assisting him with cash management and/or money transfer activities.

The account was established with an initial cash deposit of $23,700. Regular and increasing deposits are made to the account on a daily basis and periodically funds are wired to the owner’s account held at an offshore bank down south. Note also that fee income on international outgoing wires is way up because of this customer relationship. The customer also utilizes safe deposit box services and will be seeking a loan within the next few months to refinance Not-A-Felony-If-You-Don’t-Get-Caught, his yacht anchored in South Beach.

It is important to note that deposits are primarily cash so we do not have to be concerned with whether we have good funds before we send any wires. For the past two months, beginning/ending balances are $15,000 to $18,000, with $350,000 to $400,000 moving through the account each month. The customer stated he makes cash deposits because his clients are concerned about their privacy. The customer stated his activity will continue at the same levels and will likely increase.

We have discussed the possibility of floor planning their inventory, but have been told they don’t need a line of credit at this time. As their business grows, they promise to look to us to provide financing. Additionally, the customer has already referred several new customers to us because of our first class attitude toward serving the customer including Grandma’s Tattoo and Vape Parlor, American South Cannabis Growers League and the Hemp! Hemp! Hurray Farmers & Export Group.

Please advise if you need any additional information on this account.
Memorandum
To: Senior Loan Officer
From: Lola Moolah, Head Teller
Date: February 1, 2019
Subject: European Autos, Inc.

On Monday, January 28, we accepted a check for $80,000 deposited to the above account. Today, we received a telephone call from National Hankie Bankie in Next City advising us the check was being returned for insufficient funds.

As you know, Tammi Jo in Proof usually handles bad checks, but she is on vacation for the next week helping her cousin Sarah Mae move her momma (Tammi Jo’s aunt) to the Lord-and-Lady-in-Waiting Retirement Home. Since you are the account officer, I thought you should be aware of this situation.

I have placed a hold on their account for $79,900.

When I placed the hold, I noticed the customer has numerous overdrafts and the trend is increasing. Candy Barr said this wasn’t a concern, but I thought you would want to know this as well.

Is there anything else I should do to comply with any regulations or prevent loss to the bank?

Thanks in advance for your help.
Memorandum

To: Executive Committee
From: Candy Barr, Administrative Assistant and Compliance Officer
Date: May 17, 2019
Subject: Truth in Lending and RESPA Violations

The examiners cited the upcharge fee we added to appraisal fees as a Regulation Z violation.

We have always disclosed appraisal fees as separate charges to the customer on the closing statement, but the examiners have never before suggested it must be included in the finance charge.

I really argued with the examiner about this and he showed me something in Regulation Z that says we can only include the “bona fide” fees for an appraisal. I guess his position is that our charging a fee is not “bona fide.”

Also, he said that we had to “cease and desist” from collecting the full amount of our flood determination fees for loans we turn down because the portion for life-of-loan monitoring is an “unearned fee” violation of the Real Estate Settlement Procedures Act.

He said we would have to give each borrower the fees back if it was more than $100. (We might pass it off as a rebate to our customers!)

Director Roosevelt suggested we could just go back and amend our disclosures and send them to our customer. Maybe this is an option...thoughts?

Either way we have the mailing expense but the second approach would be less expensive. When you let me know your decision, I will prepare a cover letter for your review.
Memorandum

To: Executive Committee

From: Jimmy Bond, Senior Loan Officer

Date: May 13, 2019

Subject: Summary of 1st Quarter Exceptions to Loan Policy

Following the Real Estate Underwriting Guidelines, we quantified and tracked all exceptions to policy. The following were the most common exceptions to policy during the first quarter:

- Loan pricing - As you know, Anytown has an established rate each week. However, our officers are permitted to charge higher or lower rates as the market will bear. Plus, our loan officers are out in the community every day and know their customers. From my review, it appears less qualified borrowers are charged a higher rate of interest. Qualified borrowers, who have loans with us, pay a lower rate of interest than our standard rates. However, the basis for setting the different rates is not explained in the file.

- A significant number of loan files lack current and sufficient financial statements on borrowers. However, after a close review of these files I concluded financial statements are not necessary because we have an established relationship with these customers of at least 6 months.

The following are representative files from the 1st quarter for your consideration.

<table>
<thead>
<tr>
<th>Borrower</th>
<th>Date</th>
<th>Bank Rate</th>
<th>Loan Rate</th>
<th>Loan Review Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mustapha, F.</td>
<td>1/15/XX</td>
<td>7.5</td>
<td>7.0</td>
<td>Borrower vice president of Acme Widget Manufacturing. No financial statement in file.</td>
</tr>
<tr>
<td>Fletcher, S.</td>
<td>1/15/XX</td>
<td>7.5</td>
<td>8.0</td>
<td>No established credit.</td>
</tr>
<tr>
<td>Hesterlee, R.</td>
<td>1/17/XX</td>
<td>7.5</td>
<td>8.0</td>
<td>No established credit.</td>
</tr>
<tr>
<td>Patterson, T.</td>
<td>1/18/XX</td>
<td>7.5</td>
<td>7.0</td>
<td>Established depositor and borrower. No financial statement in file.</td>
</tr>
<tr>
<td>Harbert, C.</td>
<td>1/06/XX</td>
<td>7.5</td>
<td>8.25</td>
<td>Derogatory credit history.</td>
</tr>
<tr>
<td>Franco, T.</td>
<td>1/20/XX</td>
<td>7.5</td>
<td>8.25</td>
<td>Derogatory credit history.</td>
</tr>
</tbody>
</table>
Memorandum
To: Executive Committee
From: Melissa Sippy, Vice President/Bank Operations
Date: May 1, 2019
Subject: Riverside Branch Profitability Study

We have been monitoring the profitability of our Riverside Branch for the last year.

As you will recall, we established the branch at this location approximately ten years ago. At that time, there were significant business opportunities when Acme Widget Manufacturing was operating at full capacity. Due to downturns in the industry, Acme Widget Manufacturing frequently shuts down its assembly line and lays off employees.

For the last year, the Riverside Branch has been only marginally profitable. The demographics of the community do not appear to justify continuing to operate this location as a full service branch. The population in the immediate area is predominately poor people and some employers have already begun to relocate. Much of the housing is multi-family units, but the occupancy rates are over 90 percent.

I see several possible options open to us:

1. Close the branch location and absorb existing employees at the main office or our suburban branch.

2. Close the branch and donate the facility to the homeless shelter.

3. Close the branch and replace it with an interactive teller machine (ITM) that cashes checks, takes payments, etc. Note: we would be the first in the county to have an ITM.

4. Reduce office hours and offer only check cashing and deposit taking services. We could staff the office with a loan officer on an appointment only basis.

The examiners have raised the specter of “CRA” as an issue. My understanding is we are supposed to lend back to the community where our deposits originate. Our deposit base in the Riverside community is very low even though we are the only branch in a 5-mile radius. We have nothing to lose here and CRA has no penalties anyway.

My recommendation is we go with option #1 and close the branch.
Memorandum

To: Loan Committee
From: Penny Cushion, Account Officer
Date: May 14, 2019
Subject: European Autos, Inc.

The above customer relationship was targeted for review because FEAR said the transactions were excessive and high risk. I reviewed February, March, and April 2019 bank statements and noted the following:

Beginning and ending average balances have really dropped from previous months and now range between $7,000 and $9,000 each month. I thought it was strange that the averages dropped so suddenly, but noticed the funds were always “collected” because credits were mostly incoming wires, and usually within 24 hours the funds are wired out to a bank in Charlotte, NC.

The average amount of debits and credits each month has actually increased. Average debits and credits for the period were nearly equal at $650,000. Again this seemed strange, but further investigation revealed the credits were wires from European Auto’s accounts at National Hankie Bankie in Next City and the debits were a combination of outgoing wires and checks to overseas suppliers and European Auto’s owners.

I see no evidence of money laundering since the customer rarely uses cash.

Plus, my sister-in-law who recently quit her job at Whoosagoodboy Bank told me last week at the horse races that Whoosagoodboy had not filed any SARs on European Auto during the short period of time they banked there.

Let me know if you need anything else on this account.