July 30, 2018

Board of Directors
Bank of No Return
1234 Main Street
Anytown, WA 99999

Re: Compliance Examination Report and Community Reinvestment Act Performance (CRA) Evaluation

Dear Members of the Board:

Enclosed are a copy of the Compliance Report of Examination (Report) and the CRA Performance Evaluation prepared as of the close of business July 1, 2018, by Compliance Field Review Examiner U.R. Owtta-Time.

The Report reveals that the institution's overall Compliance Management System (CMS) is weak and requires strengthening. Accordingly, the institution has been assigned a composite "3" rating. The Report evidences the following major examination findings:

- Deficiencies within the bank's CMS include the following:
    - Insufficient Board and management oversight of the compliance function
    - Inadequate written policies and operating procedures
    - An ineffective training program
    - Weak internal monitoring procedures
    - An ineffective audit program

- Numerous significant violations of law including:
    - Violations of Section 5 of the Federal Trade Commission Act (Section 5) regarding unfair and deceptive acts and practices involving the bank's practice of charging a default/penalty rate of interest on credit cards.
    - Violations of Regulation Z that will require reimbursements to affected customers pursuant to § 108 of the Truth in Lending Act (TILA).
    - Pattern or practice violations of Part 339 of the FDIC Rules and Regulations regarding Flood Insurance.
    - Pattern or practice violations pursuant to §8 of the Real Estate Settlement Procedures Act (RESPA).

We trust the Board and senior management will carefully consider the recommendations and comments provided in the examination report and ensure that management implements all corrective actions.

The violations of Section 5 identified during the examination will require the institution to perform a review of all consumer credit card accounts that were assessed an elevated default rate of interest and to reimburse affected consumers for the difference between the contract rate and the elevated default rate. Management agreed to voluntarily conduct the file search and to notify and reimburse the affected customers. Within 60 days of the date of this letter, please provide this office with a listing of the customer(s) affected by the reimbursable Section 5 violations and the amount of reimbursement made for each account.

The reimbursable violations involving TILA pertain to the annual fee for the bank's "Free" credit card products and the temporary increase limit fee on all Visa credit card products. It will be necessary for the Board to ensure that management has conducted a complete file search to identify all affected borrowers. The review will include the subject annual and temporary increase limit fees assessed since the inception of both fees. Management agreed to perform the file search and to voluntarily notify and reimburse the affected customers.

Due to the presence of reimbursable violations, pursuant to Section 108(e) of TILA, the bank is request to perform the following steps:

1. Complete the file search for consumer purpose "Free" credit card loans where an annual fee was assessed and/or where a temporary increase limit fee was imposed on a Visa Credit Card and identify all consumer account where inaccurate TILA periodic statement disclosure were provided to the borrower.

2. Voluntarily reimburse affected customer(s), where appropriate, in one of the two following manners:
   a. Check mailed to the customer; or
   b. Deposit in an unrestricted consumer asset account, such as an unrestricted deposit account.

Within 60 days of this letter, please provide this office with a listing of the customer(s) affected by the reimbursable Truth in Lending violations and the amount of reimbursement made for each account. Please retain all documentation regarding the reimbursement for review by examiners at the next onsite examination.

The reimbursement procedure is outline in the "Administrative Enforcement of the Truth in Lending Act – Restitution, Joint Statement of Policy," found in the FDIC's Rules and Regulations. Additional guidance is contained in the "Interagency Questions and Answers Regarding Corrective Action Time Periods Under the Truth in Lending Act Policy Guide" issued by the FFIEC in January 1998. Further information can be found in the FDIC Compliance Examination Manual. The Examination Handbook is available on the internet at:

https://www.fdic.gov/regulations/compliance/manual/index.html

Violations of Part 339 for the FDIC Rules and Regulations regarding Flood Insurance will require the institution to perform a review of loans secured by insurable collateral located in specifically designated flood hazard areas originated during the past four years. The results of the full loan file review have been provided to this office. The potential assessment of a civil money penalty pertaining to Flood Insurance will be addressed in supplemental correspondence.

The CMS weaknesses and the resultant violations that were cited at this examination raise supervisory concerns. The Board is asked to sign a Memorandum of Understanding (MOU) to address the compliance management system deficiencies noted in the Report. Execution of the MOU will evidence the commitment of the Board to address the actions necessary to improve the banks overall posture. The MOU prepared by the FDIC for signature by the bank accompanies this correspondence. Please review the MOU and be prepared to sign it at our meeting with you scheduled for September 15, 2018. Upon execution of the MOU by the FDIC Regional Director, a fully executed copy will be returned to the Board.

Please note that the MOU requires the Board to provide quarterly reports to this office and receipt of the first quarterly report will be due no later than October 31, 2018. Please provide a copy to the FDIC's Anytown Field Office at 1525 N. Main Street, Suite 3B, Anytown, WA 99998, Attn: Acting Filed Supervisor V. Rey Sirrius.

The results of the compliance examination, including the Consumer Compliance rating, are subject to the confidentiality restrictions of Part 309 of the FDIC Rules and Regulations.

A CRA rating of "Needs Improvement" is assigned to your institution. Please refer to the CRA Performance Evaluation for additional details.

Within 30 business days of its receipt, the enclosed Performance Evaluation must be placed in the institution's CRA public file. The format and content of this evaluation may not be altered or abridged in any manner. Upon request, a copy of your current evaluation must be provided to the public. This bank is authorized to charge a fee not to exceed the cost of reproduction and mailing (if applicable).

Please review the Report at an official meeting of the Board of Directors and provide a written response to the Report's findings within 45 days of receipt of the Report. If there are any questions regarding the enclosed report, please contact Acting Field Supervisor V. Rey Sirrius at (555) 555-1212.

Sincerely,

I. T. Sallover
Regional Director
Anytown Region

SCOPE OF THE EXAMINATION

A compliance examination of Bank of No Return was conducted as of April 15, 2018, by FDIC Examiner U.R. Owtta-Time. The examination included a review of the bank's efforts to administer an effective compliance management system to ensure compliance with applicable consumer protection and fair lending laws and regulations. In addition, examiners evaluated Bank of No Return's performance under the Community Reinvestment Act (CRA).

The compliance examination procedures included a review of compliance-related policies and procedures, training efforts, internal audits, Board and audit committee minutes, loan files, initial disclosures, and other bank records. Extensive interviews with management and other key personnel were conducted to determine the extent to which written and unwritten policies and procedures were implemented. Documentation related to specific loan, deposit, and other compliance-related transactions was also reviewed to evaluate operational effectiveness. The compliance examination focused on the bank's activities since the previous examination on June 17, 2013, which was conducted by the Federal Reserve Bank.

CONSUMER COMPLIANCE RATING

A Consumer Compliance Rating of "3" is assigned. An institution in this category is in less than satisfactory compliance position. The institution's compliance posture has deteriorated since the previous compliance examination and is a cause for supervisory concern that will require more than normal supervision to remedy deficiencies. The Board of Directors and senior management has not provide adequate oversight of the banks compliance program and audit function and the bank's written and unwritten policies and procedures have proven ineffective. Based on the findings of this examination, is it evident that the banks compliance training program has been unsuccessful. In addition, a lack of compliance-related monitoring efforts has adversely affected the bank's compliance posture. Finally, the bank's audit function, as administered at the start of this examination, is weak. Following is further discussion of the bank's compliance management system.

COMPLIANCE MANAGEMENT

Board and Senior Management Oversight

Board and Senior management oversight is weak.

The level of compliance-related controls, internal reporting, and accountability with the oversight structure of the compliance area does not enable the Board or senior management to effectively assess the institution's compliance posture. The chief weaknesses of the Board and senior management's oversight are the lack of sufficient resources and insufficiently trained personnel, non-existent monitoring procedures, and over reliance on the internal audit to identify any and all infractions. In addition, the Board and senior management have not been proactive in administering their oversight duties and responsibilities.

Although the Board has appointed a Compliance Officer and established a comprehensive compliance policy, these measures have proven ineffective in maintaining an adequate compliance posture. The Compliance Officer is assisted by three other bank employees, who together with the Compliance Officer comprise the bank's compliance department. The main responsibilities of the bank's compliance department are to ensure adequate reporting of the bank's Home Mortgage Disclosure Act (HMDA) data and to provide training to bank employees. Given the magnitude of the significant violations noted in this report, it is apparent that more extensive compliance training is warranted. Additionally, management needs to establish procedures to measure employees' compliance knowledge once training has been provided. The bank's compliance department needs to exercise a higher degree of management over the bank's adherence to consumer-related laws and regulations. The bank's activities do not include monitoring procedures, which assist management in measuring the bank's compliance with consumer-related laws and regulations. Examiners recommend that bank officials establish daily, weekly, and monthly monitoring procedures, as appropriate, to measure the bank's compliance. It is the responsibility of the Board and senior management to ensure that department managers understand consumer protection laws and regulations as they relate to their responsibilities. Given the decentralized nature of the bank's structure and that each branch operates with a great deal of autonomy, the importance of branch managers recognizing and understanding consumer protection laws and regulations and adhering to these laws and regulations increases.

The Board has established an internal auditing schedule for compliance-related activities. The bank's internal audit department conducts a risk-based compliance audit every two years. However, examiners identified weaknesses in the bank's overall audit process. These weaknesses included a practice of incorrectly identifying areas reviewed, lack of investigation regarding reports from department managers, ineffective communication between the audit and compliance departments, and lack of specialized compliance knowledge within the audit department given the complex nature of the bank's products. It is the Board and senior management's responsibility to ensure that audit processes utilized by the bank adequately address the bank's needs.

Finally, the Board of Directors and senior management failed to address significant violations identified at the previous examination. Weaknesses in the bank's monitoring of loans secured by improved property in a flood hazard area were identified at the previous examination and bank officials failed to adequately address those weaknesses. Continued deficiencies reflect negatively on the Board of Directors and senior management. The Board is ultimately responsible for developing and maintaining an adequate compliance management system.

Compliance Program

The existing compliance program is weak.

Policies and Procedures

While the bank's compliance program operates under the guidance of a Board-appointed compliance officer and a written compliance policy, these measures have not proven effective in maintaining an adequate compliance posture. The compliance officer lacks the necessary authority and skills to adequately manage the bank's compliance program. Each branch office operates with a high degree of autonomy and compliance officer recommendations are treated as suggestion with no adverse actions if branch managers or loan officer disregard those recommendations. Effective policies and procedures are imperative given the large number of loan product lines offered by the bank and its current office structure.

Monitoring

The bank does not have a compliance monitoring program and the lack of this critical internal control function contributed to most of the exceptions noted during this examination remaining unidentified and uncorrected for extended periods. Compliance monitoring procedures should provide for the review of all compliance related activities performed by the bank on a routine basis. Compliance monitoring is the bank's best means for identifying and correcting errors resulting from:

- Inadequate training,
- Ineffective procedures,
- The use of incorrect standardized forms,
- Errors attributable to third-party vendors, and
- Previously implemented corrective action that has not been fully effective.

Periodic reports on the findings of the monitoring reviews should be provided to the Board and senior management. Routine monitoring represents a proactive approach to compliance by seeking to identify and correct violations in a timelier manner than is possible through the use audits.

Training

The bank does have a training program; however, training efforts have been ineffective. A combination of internal and external training is used by the bank. The majority of training conducted since the prior examination has been flood insurance related. The Compliance Officer conducted the bank's internal training during the past two years. This training included presentation of compliance topics to various department and branch personnel. Additionally, a representative of FEMA conducted various flood training at several branch locations. Given the level of noted violations, it is apparent the bank's training efforts were unsuccessful, and that improvements to the bank's training program are necessary. Examiners recommend that bank officials expand the training program to include emerging issues, such as Non-Traditional Mortgages and high risk areas, such as credit card lending. Additionally, examiners recommend that the bank's training program include methods to gauge employee retention of training.

Consumer Complaints

The bank's consumer complaint process is outlined in the bank's overall compliance policy. The bank's procedures are adequate with senior management and the Board advised of consumer complaints as warranted.

Audit Function

The audit function is weak.

Since the previous examination, management has relied solely on internal compliance audits to identify deficiencies. The Board and the Audit Committee should ensure that the scope and detail of compliance audits are sufficient to not only identify exceptions but also provide an accurate assessment of the bank's compliance posture. Additionally, the Board and the Audit Committee should direct the internal auditor to identify areas not reviewed as part of the internal audit, rather than to include audit findings based on information reviewed at the prior audit. Through review of internal audit work papers, examiners identified several violations and compliance program concerns that were not identified in the February 2018 internal audit. Also, the audit did not comment on the critical weakness in the bank's compliance management system arising from the lack of a compliance monitoring program that would enable the bank to proactively address potential compliance issues, program weaknesses, and violations. In short, the compliance audit did not provide the Board with a basis to accurately assess the bank's compliance posture.

The Board and Audit Committee should strengthen the bank's audit program to ensure an accurate risk scope is established based on products offered, prior deficiencies, and emerging industry guidance. Absent strong monitoring procedures, the Board should increase the frequency of the compliance internal audit. Additionally, examiners recommend that the Board and Audit Committee ensure greater communication between the compliance and audit departments.

Please refer to the Significant Violations pages for further details on all significant violations found during the compliance examination. Please refer to the Other Violations pages for details on isolated or technical violations found during the examination.

UNFAIR AND DECEPTIVE ACTS AND PRACTICES

Section 5 of the Federal Trade Commission (FTC) Act prohibits "unfair or deceptive acts or practices" by banks. The standards for unfairness and deception are independent of each other under Section 5. While a specific act or practice may be both unfair and deceptive, an act or practice is prohibited by the FTC Act if it is either unfair or deceptive.

Examiners identified violations of Section 5 of the FTC Act for unfair and deceptive acts and practices regarding the bank's practice of charging a default/penalty rate on credit cards when the application of such a rate is not included in the legal contract between the bank and the customer. Reimbursement to all affected consumers of the difference between the default rate and the interest rate that is permitted by the terms of the credit card agreement will be necessary.

For additional information refer to the Significant Violations Pages.

REIMBURSABLE TRUTH IN LENDING VIOLATIONS

Two reimbursable Truth in Lending violations were identified during the examination.

The first violation involves the failure to disclose an annual fee as a finance charge. On the bank's Free Credit Card accounts, the annual fee is waived with 12 transactions of retail activity in the past 12 months. Therefore, the annual fee is considered a finance charge and must be disclosed using the term "finance charge" on the periodic statement. The bank must make appropriate monetary payments to all affected consumers. This reimbursable error affects an estimated 5,088 consumer accounts and the estimated total reimbursement is $102,765.

The second violation involves the assessment of a "Temporary Increase Limit Fee." This fee is disclosed on the period statement as a "temporary increase fee"; however, this fee is not reflected as a "finance charge" on the periodic statement. Because the fee does not satisfy the criteria for exclusion from being considered a finance charge, it must be identified and disclosed on periodic statements as a finance charge. Bank officials conducted a file search and identified 8,132 instances relating to the temporary credit increase fee; reimbursement amount equates to $81,320.

During the examination, bank officials agreed to reimburse customers for both pattern and practice violations noted above. Refer to the Significant Violations Pages for additional details regarding the reimbursement violations.

CIVIL MONEY PENALTY

Patterns and/or practices of flood insurance loan violations were identified for the second examination in a row. As a result, a recommendation for a civil money penalty for these violations is appropriate. The Board of Directors will be advised of decisions regarding this recommendation in separate correspondence.

RECOMMENDATIONS FOR CORRECTIVE ACTION

As discussed in the sections above and on the previous pages, the institution is in a less than satisfactory compliance position and the institution's compliance management system is considered ineffective due to weak oversight provided by the Board and senior management, a weak compliance program, and a weak audit function. The Board should take the following actions to address the weaknesses identified by the examination:

- Increase oversight of the bank's compliance function. Monthly reports by the compliance officer detailing compliance activities should be required and the reports should include descriptions of actions taken by the bank with respect to the violations and deficiencies presented in the Compliance Report of Examination.
- Perform a full review of the bank's compliance policies and procedures and then create or enhance detailed operating procedures and controls where necessary to ensure compliance with all consumer protection laws and regulations.
- Establish monitoring procedures to ensure compliance with all consumer protection laws and regulations.
- Perform a full review of the compliance audit program, augment the scope of compliance audits, and improve the quality of compliance audits as necessary to ensure compliance with all consumer protection regulations.
- Reevaluate and enhance the ongoing training program for all bank personnel, including the Board of Directors and audit and compliance staff.
- Commission an independent assessment of bank employee knowledge, expertise, and staffing levels within the Internal Audit, Credit Card, and Compliance departments and submit the findings to the FDIC Regional Director for review and comment. Such assessment should consider the future growth and expansion plans of the institution.
- Ensure that the staff and resources dedicated to compliance management are commensurate with the institution's size and structure, and that the compliance officer, together with all parties with compliance oversight responsibilities, receives training, resources, and authority necessary to effectively oversee the bank's compliance with all relevant consumer protection laws and regulations.
- Establish flood insurance monitoring procedures to ensure compliance with flood insurance requirements.
- Complete restitution for Truth in Lending violations in accordance with the reimbursement provisions of the Truth in Lending Act.
- To the extent possible, correct all violations listed in the Report of Examination and implement appropriate procedures to prevent their recurrence.

COMMUNITY REINVESTMENT ACT

A CRA rating of "Substantial Noncompliance" is assigned. An institution in this group has a substantially deficient record of helping to meet the credit needs of its assessment area, including low- and moderate-income neighborhoods, in a manner consistent with its resources and capabilities.

Lending Test

The Bank of No Return's lending levels represent poor responsiveness to its assessment areas' credit needs. The bank has a substantial majority of loans made outside its assessment areas. The geographic distribution of small business and home mortgage loans reflects inadequate penetration throughout the assessment areas. The Bank of No Return's distribution of the loans to borrowers reflects, given the product lines offered by the institution, overall poor penetration among business customers of different sizes and retail customers of different income levels. The institution exhibits an inadequate record of serving the credit needs of the most economically disadvantaged areas of its assessment area's, low-income individuals, and/or very small businesses, which is inconsistent with the requirements of the Act.

The bank has made a low level of community development loans as compared to their peers, considering the performance context for this institution. While the bank does use flexible lending practices to serve the credit needs of its assessment areas, it makes no use of innovative lending practices.

Investment Test

Given the opportunities in the assessment areas, the bank has an inadequate level of qualified community development investments and grants. The bank exhibits a lack of responsiveness to credit and community economic development needs, based on review of both the qualified investment opportunities available and the community development needs of the assessment areas. Further, the bank does not use innovative or complex investments to support community development initiatives.

Services Test

Delivery systems are accessible to essentially all portions of the assessment areas. The Bank of No Return has numerous offices and automated teller machines (ATMs) throughout the assessment areas, as well as other alternative delivery systems, such as phone and Internet banking. The institution's record of opening and closing branches has improved the accessibility of its delivery systems, particularly in moderate-income geographies, and to low- and moderate-income individuals. The bank opened 13 new branches since the prior evaluation throughout various parts of Washington and Idaho. Services do not vary in a way that inconveniences portions of the assessment areas, particularly low- and moderate-income geographies and individuals. The lobby and drive-up facilities have reasonable business hours and have services available Monday through Friday to help make services accessible to all segments of the community. The bank provides an adequate level of community development services.

Please refer to the Performance Evaluation for a discussion of the bank's CRA performance.

<u>**ENFORCEMENT ACTIONS**</u>

Given the deficiencies identified in the bank's CMS and the corresponding assignment of a "3" rating, a commitment from the Board in the form of a Memorandum of Understanding is requested.

MEETING WITH MANAGEMENT

On May 16, 2018, the Examiner-in-Charge (EIC), Field Supervisor, and Financial Institution Specialist met with management to discuss the results of the compliance examination and the CRA evaluation. Representing the institution were the Chief Executive Officer, the Executive Vice Presidents, the Compliance Officer, and the Chief Auditor. Also in attendance were the bank directors that sit on the Audit Committee. Attending on behalf of the FDIC via teleconference was a Senior Compliance Examiner, who presented the CRA findings.

The EIC discussed the weaknesses of the bank's compliance management system and the noted violations identified during the exam. The recommendations made to improve the bank's compliance posture were discussed in detail. The CEO stated that the recommendations would be very expensive, and would seriously impact the profitability of the bank, although the bank would, upon direction from the FDIC, perform the file review and Truth in Lending reimbursement. The Compliance Officer and the Chief Risk Officer stated that the bank began implementing changes to the bank's compliance management system recommended by the EIC. The bank's CRA performance was also discussed in detail.

The recommended ratings for compliance and CRA were not discussed. Management was informed that as soon as required consultations with the San Francisco Regional Office were completed the EIC would contact bank management and disclose the recommended ratings for compliance and CRA.

Significant Violations

<u>FEDERALTRADE COMMISSION ACT - UNFAIR OR DECEPTIVE ACTS OR PRACTICES</u>

Section 5 of the Federal Trade Commission Act prohibits unfair acts or practices. An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair.

Section 5 of the Federal Trade Commission Act prohibits deceptive acts and practices. To determine whether a representation, omission, or practice is "deceptive," a three-part test is used. First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission or practice must be reasonable under the circumstances. Lastly, the misleading representation, omission, or practice must be material.

<u>Unfair and Deceptive Credit Card Practices</u>

The bank offers a “Free” card program. Bank officials charge an annual fee for the card and failed to disclose a penalty rate (aka default rate) in the initial disclosure and more importantly in the legal agreement. When the credit card is mailed to the cardholder, the card is attached to the initial disclosure. This disclosure does not contain any reference to a penalty rate or an annual fee. Bank Officials attempted to disclose an annual fee and a penalty rate in the bank's "take one" application forms; however, asterisks were misplaced and/or absent from these forms which would have led the consumer to information regarding a penalty rate or annual fee. The card holder agreement does not give the bank the right or authority to increase the interest rate in the event of default.

<u>Unfair Practices</u>
It is the bank's practice to impose a default rate when the customer is 60 days or more past due and the bank's practice appears to be legally unfair. The injury to affected consumers is substantial, is not outweighed by any offsetting consumer or competitive benefits, and is not an injury the consumer could reasonably have avoided. The injury is substantial because it results in a rate increase from 4.5 percent to as much as 9.00 percent and the elevated rate remains in effect for a minimum of 12 months. There is no offsetting consumer or competitive benefit to the practice of creating contractual obligations by disclosing terms that are not part of the legal obligation. This is evidenced by the fact the basic precept of the Truth in Lending Act is to ensure the terms of consumer loans are accurately, clearly, and consistently disclosed to the consumer. Finally, consumers are entitled to rely upon the terms of the card agreement that sets forth the legal obligation of the parties and the consumer. Under the terms of the agreement, the consumer would have an expectation that late payments would result in late charges not to exceed $25 per late payment, but would not be advised that an increased rate of interest would be imposed. The fact that earlier disclosures contained inaccurate information regarding the terms of the card agreement cannot be seen as modifying the terms of the agreement because the final

disclosure provided to the consumer accurately represented the terms of the agreement and as the final version of the Truth in Lending Act required disclosures, replaced and superseded the earlier erroneous disclosures.

Deceptive Practices

As indicated above, examiners reviewed various "take one" applications and card holder agreements during the examination. The "take one" applications were revised since the prior examination. Additionally, examiners reviewed a "VISA Credit Card Disclosure" that is utilized when bank personnel open a credit card account. This disclosure appears to have been modified in 2013 and in 2014. On the "take one" applications" and the ''VISA Credit Card Disclosure" the use of a penalty/default rate was not adequately disclosed. More importantly, the card holder agreement and initial disclosure did not make any reference to the penalty/default rate. Failure to adequately disclose the default rate and annual fee or to omit information regarding the default rate is likely to mislead customers regarding circumstances which trigger application of said rate. Regardless of how the penalty information was disclosed on the "take one" application and the "VISA Credit Card Disclosure," customers are likely to infer that a penalty rate or annual fee is not applicable since neither the card holder agreement nor the initial disclosure contains information regarding the penalty rate or annual fee. The practice of applying a penalty rate is material because it results in a rate increase from 4.5 percent to as much as 9.00 percent and the elevated rate remains in effect for a minimum of 12 months.

Bank officials provided examiners with a worst case scenario based on the balance at the time the account went into delinquency/penalty pricing. This scenario identified 5,088 accounts with an estimated dollar impact of approximately $102,765. The bank must reimburse all affected consumers; provided, however, restitution will not be required for violations occurring more than six years prior to the examination date. This analysis does not take into account the fluctuations in the average daily balance during the 12 months following delinquency.

Bank officials also provided examiners with a worst case scenario based on the reimbursement of the annual fee of $20. This scenario identified 35,157 accounts with an estimated dollar impact of approximately $3,515,700. The bank must reimburse all affected consumers; provided, however, restitution will not be required for violations occurring more than six years prior to the examination date.

Examiners attribute the violation to inadequate oversight and lack of monitoring. The Chief Lending Officer indicated bank officials discontinued charging a default rate and an annual fee during the examination and that disclosures are being modified to accurately reflect all of the bank's practices.

FLOOD INSURANCE

Section 339.3(a) of FDIC regulations prohibits a financial institution from making, increasing, extending, or renewing a designated loan secured by a building, a mobile home, or personal property unless the underlying security is covered by flood insurance.

In total, examiners reviewed a sample of 99 loans secured by improved property located in a Special Flood Hazard Area (SFHA). In 19 of the loans reviewed, there was no flood insurance in place at the time of origination. While bank officials provided external and internal training, the training has proven ineffective. Examiners attribute the violation to inadequate monitoring procedures and ineffective training procedures.

Section 339.3(a) of FDIC regulations requires that the building, mobile home, or personal property securing a designated loan be covered by flood insurance for the term of the loan.

Examiners reviewed a sample of 99 loans secured by structures located in a SFHA. In 10 of the loans reviewed, flood insurance was not maintained during the term of the loan. There were various lapses in flood insurance and the bank's monitoring system did not detect these lapses. The bank's flood tracking system is not all inclusive and does not contain all of the loans that are secured by improved property located in a SFHA. Examiners attribute this violation to a deficiency in Board and senior management oversight, ineffective training procedures, and inadequate monitoring procedures.

Section 339.3(a) of FDIC regulations requires that the amount of insurance must be at least equal to the lesser of the outstanding principal balance of the designated loan or the maximum limit of coverage available for the particular type of property securing the loan.

Examiners reviewed a sample of 99 loans secured by structures located in a SFHA. 14 of the loans reviewed, the proper amount of flood insurance was not obtained either at origination or during the term of the loan. Bank personnel are computing the value of buildings in different manners, especially when there is no formal appraisal completed for the property. Examiners attribute this violation to a deficiency in Board and senior management oversight, ineffective training, and inadequate monitoring procedures.

Section 339.9(a) of FDIC regulations requires a financial institution to furnish a written notice to the borrower and to the servicer in all cases whether or not flood insurance is available under the Act for the collateral securing the loan when making, increasing, extending, or renewing a loan secured by a building or a mobile home located or to be located in a designated special flood hazard area.

Examiners reviewed a sample of 99 loans secured by structures located in a SFHA. In 11 loans reviewed, the borrower was not provided with a flood notice, Discussions with bank personnel determined that many loan officers are not giving a written notice to borrowers for renewal loans. Examiners attribute this violation to a deficiency in Board and senior management oversight, ineffective training, and inadequate monitoring procedures.

Section 339.9(c) of FDIC regulations requires that the financial institution provide the notice required by paragraph (a) of this section to the borrower within a reasonable time before the completion of the transaction, and to the servicer as promptly as practicable after the financial institution provides

notice to the borrower and in any event no later than the time the bank provides other similar notices to the servicer concerning hazard insurance and taxes.

Examiners reviewed a sample of 99 loans secured by structures located in a SFHA. In 17 of the loans reviewed, the notice was not provided in a reasonable period of time before loan origination. In many instances, the written notice appears to have been given at loan closing. In addition, there were instances that loans were originated without flood insurance; therefore, it appears borrowers are not receiving timely notice to purchase flood insurance before loan origination. Examiners attribute this violation to a deficiency in Board and senior management oversight, ineffective training, and inadequate monitoring procedures.

Upon notification of the aforementioned flood insurance violations, senior management agreed to centralize the bank's flood insurance documentation process. Loan Servicing now oversees the bank's compliance with the flood insurance regulation. Loan Services will begin providing flood insurance loan documentation support to all bank locations and will maintain the bank's flood insurance tickler system. The bank's compliance department reconciled the bank's flood determination third-party provider list to the bank's loan portfolio during the examination. Changes to procedures include members of Loan Servicing sending letters to customers as their flood insurance policies are set to expire. The department has been instructed by senior management to force place flood insurance policies within 45 days from expiration. Additionally, all new flood determinations are delivered to Loan Servicing from the third-party provider and Loan Servicing will not generate loan documents until evidence of flood insurance is provided. These monitoring procedures will assist in eliminating flood insurance pattern and practice violations.

TRUTH IN LENDING - OPEN-END CREDIT - Non-reimbursable

Section 226.5(c) of Regulation Z requires the creditor to make disclosures which reflect the terms of the legal obligation between the parties involved and, when any information necessary for accurate disclosures is unknown, to clearly state that the disclosure is an estimate.

As previously noted, the bank has take-one applications for various credit cards it offers. From November 2005 to the date of the examination, the bank had a take-one application for the “Free” card.

The bank disclosed penalty/default rates for purchases and cash advances but the card holder agreement does not give the bank the right or authority to increase the interest rate in the event of default.

The violation is attributed to not being aware of the regulation requirements and inadequate audit procedures. Additional training on the regulation requirements is needed. During the examination, bank officials discontinued charging a penalty fee.

TRUTH IN LENDING - CLOSED-END CREDIT - Non-reimbursable

Section 226.18(d) of Regulation Z requires disclosure of the "finance charge," using that term, and a brief description such as "the dollar amount the credit will cost you". The finance charge shall be considered accurate for mortgage loans if it is understated by no more than $100, or if it is greater than the amount required to be disclosed. The finance charge shall be considered accurate for non-mortgage loans if it is not more than $5 above or below the exact finance charge in a transaction involving an amount financed of $1,000 or less, or not more than $10 above or below the exact finance charge in a transaction involving an amount financed of more than $1,000.

Examiners reviewed 16 residential real estate loans subject to Regulation Z that were sold on the secondary market and 20 that were retained in-house. In four instances, the finance charge was understated on the final TIL disclosure. For 3 of 36 loans, the bank failed to include certain fees in the prepaid finance charge calculation. Specifically, the escrow fee, closing fee, wire transfer fee, and/or courier fee were incorrectly excluded from the finance charge. In one of the four loans, the bank used an incorrect commitment amount to calculate the finance charge. These errors caused the finance charge to be understated by more than the allowed legal tolerance. However, due to the structure of the loans that were affected by this violation, the disclosures did not exceed the allowed tolerance for reimbursement purposes and FDIC is not required to seek restitution on behalf of the borrowers. Management may wish to discuss its potential civil liability under the Consumer Credit Protection Act and Regulation Z with qualified legal counsel. Examiners attribute this violation to a deficiency in training. Because violations of this nature can result in reimbursement directives, management should ensure that training is provided to all appropriate personnel and that appropriate internal controls are in place to effectively monitor for compliance with this regulation.

HOMEOWNERSHIP PROTECTION ACT

Section 4(a) (1) (A) of the Homeowners Protection Act requires specific information on the initial disclosures for a fixed rate residential mortgage transaction. This information includes an initial amortization schedule, notice of the borrower's right to request the cancellation of the private mortgage insurance (PMI) at a scheduled or actual 80% loan-to-value level, the automatic termination date when the PMI is scheduled to reach a 78% loan-to-value level, and the Act's exemptions from cancellation or termination.

Examiners reviewed six loans with private mortgage insurance (PMI) originated by the bank and subsequently sold on the secondary market. In two instances, the PMI initial disclosure contained incorrect cancellation and termination dates. Examiners attribute this violation to a deficiency in training.

FAIR CREDIT REPORTING ACT

Section 604(b)(3) of the Fair Credit Reporting Act requires the user of a consumer report for employment purposes to provide to the consumer, before taking any adverse action based in whole or in part on the consumer report, a copy of the report and a written description of the rights of the consumer under the Act.

In all instances where the bank denied an application for employment based in whole or in part on credit report information, the bank did not provide the applicant with a copy of the credit report as required by this section. Examiners attribute this violation to a deficiency in training.

Other Violations

TRUTH IN LENDING

Section 226.19(a)(1) of Regulation Z requires, in a residential mortgage transaction subject to RESPA, that the creditor make good faith estimates of the disclosures required by Section 226.18 before consummation or deliver or mail them not later than three business days after receipt of the consumer's written application, whichever is earlier.

Examiners reviewed 12 residential mortgage transactions where the bank was required to provide the early TIL (ETIL) disclosure. In two instances, the ETIL disclosure was not provided. This section requires that the ETIL disclosure be provided within three business days of receiving the application for credit. Examiners attribute this violation to a deficiency in monitoring.

Section 226.19(b)(1) of Regulation Z requires for variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year that the booklet titled Consumer Handbook on Adjustable Rate Mortgages or a suitable substitute be provided with the application or before the consumer pays a nonrefundable fee, whichever is earlier.

Section 226.19(b)(2) of Regulation Z requires for variable-rate transactions secured by the consumer's principal dwelling with a term greater than one year that the creditor provide disclosures for each such loan program in which the customer expresses an interest at the time an application form is provided or before the customer pays a nonrefundable fee, whichever is earlier.

Examiners reviewed one in-house adjustable rate mortgage (ARM) loan and noted that the bank did not provide the Consumer Handbook on Adjustable Rate Mortgages and the ARM disclosure to the applicant as required.

Section 226.18(e) of Regulation Z requires that the annual percentage rate be accurately disclosed, as defined in Section 226.22(a).

AS previously mentioned, examiners reviewed 16 residential real estate loans subject to Regulation Z that were sold on the secondary market and 20 that were retained in-house. For one in-house loan, the bank failed to include the $400 escrow fee in the finance charge. This error caused the APR to be understated. However, due to the structure of the loan that was affected by this violation, the disclosed APR was understated in an amount that did not trigger restitution to the borrower. Examiners attribute this violation to a deficiency in training.

Section 226.18(g) of Regulation Z requires that the number, amounts and timing of payments be accurately disclosed.

Examiners reviewed six residential real estate loans with private mortgage insurance (PMI) originated by the bank: and sold on the secondary market. In one instance, the payment streams on the final TIL disclosure did not accurately reflect the termination of PM I. Because the PMI was reflected in the payment stream for a longer period than allowed, it resulted in an overstated finance charge. Examiners attribute this violation to a deficiency in monitoring.

Examiners reviewed 34 residential real estate loans and in one isolated instance, the Truth in Lending (TIL) disclosures did not accurately reflect the terms of the note contract. In this instance, the payment stream disclosed on the final TIL disclosure did not match the payments disclosed on the promissory note. The TIL disclosures should reflect the terms that the borrower is legally bound by the note contract.

REAL ESTATE SETTLEMENT PROCEDURES

Section 3500.7(a) of Regulation X of the Department of Housing and Urban Development requires the lender to provide the good faith estimate to all applicants by delivery or mail not later than three business days after the application is received or prepared. (If mortgage broker is the exclusive agent of the lender, either shall provide the good faith estimate.)

Examiners reviewed 31 residential real estate loans subject to the aforementioned disclosure requirements. In one instance, the bank did not provide the good faith estimate (GFE) to the applicant. This violation is attributed to oversight.

Section 3500.7(c) of Regulation X of the Department of Housing and Urban Development requires that the good faith estimates will consist of estimated charges that will be listed on the HUD-l or HUD-1A and that the borrower will normally pay or incur based on common practice in the locality of the mortgaged property and will bear a reasonable relationship to the charges a borrower is likely to be required to pay at settlement.

Examiners reviewed 31 residential real estate loans subject to the Good Faith Estimate (GFE) requirements of RESPA. In two instances, the GFE did not reflect all of the charges a borrower would normally pay based on common practices. Examiners attribute this violation to a deficiency in the bank's monitoring procedures.

Section 3500.8(a) of Regulation X of the Department of Housing and Urban Development requires that the settlement agent shall use the HUD-l settlement statement in every settlement involving a federally-related mortgage loan. The HUD-IA form may be used for transactions in which there is a borrower and no seller, such as refinancing loans and subordinate lien loans.

Examiners reviewed 27 residential real estate loans subject to RESPA. In 1 isolated instance, the bank failed to provide the HUD-IA settlement statement to the borrower as required.

Section 3500.21(d)(3) of Regulation X of the Department of Housing and Urban Development requires that the transfer notice contain the following information:

- **Effective date of the transfer;**
- **Name, address, and toll-free or collect telephone number of the new servicer; toll-free or collect telephone number for an individual with the present servicer to answer inquiries relating to the transfer of servicing;**
- **Date on which the present servicer stops accepting payments on the loan and the date the new servicer begins accepting payments on the loan, (these dates shall be either the same or consecutive days);**
- **Information on the effect the transfer may have on the terms or continuance of optional insurance and any action the borrower must take to maintain coverage;**
- **A statement that the transfer of servicing does not affect any terms or conditions of the mortgage documents other than those directly related to servicing the loan; and**
- **A statement of the borrower's rights in connection with complaint resolution.**

Examiners reviewed 15 residential real estate loans sold on the secondary market where the servicing of the loan was transferred. In 1 isolated instance, the toll-free or collect telephone number for the present servicer was not disclosed to the consumer on the transfer notice.

EOUAL CREDIT OPPORTUNITY ACT

Section 202.9(a)(1) of Regulation B requires a creditor to notify an applicant of action taken on a credit application within prescribed time limits.

Examiners reviewed nine consumer applications and four residential real estate applications denied by the bank. In two instances, the applicant was either not notified of the reason for the action taken, or was not notified within prescribed time limits. For one consumer loan application, the statement of the action taken was not disclosed on the adverse action notice. For one residential real estate application, the bank did not provide the adverse action notice to the applicant within 30-days of receiving a completed application. The application was denied due to delinquency 152 days after the application was received.

Section 202.9(a)(2)(i) and (ii) of Regulation B requires a creditor to provide an applicant, against whom adverse action is taken, a written notice of such action that includes a statement of specific reasons for adverse action or a disclosure of the applicant's right to request a statement of specific reasons within 60 days.

Examiners reviewed nine consumer applications and four residential real estate applications denied by the bank. In one instance, the adverse action notice stated that the application was denied for an insufficient credit report file. However, the credit report observed in the file indicates that the applicant had several trade lines with severe delinquency. The denial reason should have been disclosed as delinquent credit obligations.

Section 202.9(a)(2) of Regulation B requires a creditor to provide an applicant against whom adverse action is taken a written notice of such action that includes disclosure of the-name and address of the Federal Deposit Insurance Corporation's Consumer Response Center.

Examiners reviewed nine consumer applications and four residential real estate applications denied by the bank. In 11 instances, the name and address of the Federal Deposit Insurance Corporation (FDIC) was incorrect on the adverse action notice. Specifically, in three instances, the address for the FDIC's San Francisco Regional Office was disclosed rather than the National Consumer Response Center, and, the addressee was shown as Director of Compliance and Consumer Affairs rather than the National Consumer Response Center in eight instances.

FAIR CREDIT REPORTING

Section 609(g) of the Fair Credit Reporting Act requires that any person who makes or arranges loans and who uses a consumer credit score as defined in subsection (1), in connection with an application initiated or sought by a consumer for a closed end loan or the establishment of an open end loan for a consumer purpose that is secured by 1 to 4 units of residential real property shall provide the credit score and certain other information required by this section including the Notice to Home Loan Applicant, as soon as is reasonably practicable.

Examiners reviewed 31 originated residential real estate loans subject to Section 609(g) of the FCRA. In one instance, the bank did not provide the credit score disclosures to the applicants as required.

TRUTH IN SAVINGS

Section 230.6(a) of Regulation DD requires that, if a periodic statement is provided, it must disclose the annual percentage yield earned (using this term), amount of interest, fees imposed, and length of statement period.

Examiners reviewed the periodic statement for the bank's Absolutely Wonderful Imaging Account and noted that the service charge was not itemized by type and dollar amount Specifically, the periodic statement showed a combined monthly service charge of $12. The service charge should have been itemized to show a monthly service charge of $9 and a returned image statement charge of $3. Examiners attribute this violation to a deficiency in the bank's procedures.

HOME MORTGAGE DISCLOSURE (HMDA)

Section 203.4(a) of Regulation C requires a nonexempt financial institution to collect certain data on applications for, and originations, purchases and refinancings of, home purchase and home improvement loans for each calendar year. These transactions shall be recorded on a register in the format prescribed in Appendix A.

Examiners reviewed a sample of 40 applications selected from the 410 applications reported on the bank's 2016 HMDA LAR to determine the bank's compliance with the above regulation. This review revealed that the bank's 2016 LAR contained one data error. Bank officials recorded an incorrect census tract on the LAR. This violation is attributed to oversight.