



# COMPLIANCE UPDATE

## JOINT STATEMENT ON THE NEW ACCOUNTING STANDARD ON FINANCIAL INSTRUMENTS—CREDIT LOSSES

The regulatory agencies issued a Joint Statement on the New Accounting Standard on Financial Instruments—Credit Losses, regarding the Financial Accounting Standards Board (FASB)’s new standard, which introduces the Current Expected Credit Losses (CECL) methodology for estimating allowances for credit losses. The joint statement also provides initial supervisory views regarding the implementation of the new accounting standard.

### Highlights:

- Under CECL, the allowance for credit losses is a valuation account measured as the difference between the amortized cost basis of financial assets and the net amount expected to be collected on the assets (i.e., lifetime credit losses).
- The new accounting standard will take effect in 2020 or 2021, depending on an institution's characteristics. It applies to financial assets carried at amortized cost, including loans held for investment and held-to-maturity securities.
- The standard allows expected credit loss estimation approaches that build on existing credit risk management systems and processes as well as existing methods for estimating credit losses. However, certain inputs into these methods will need to change to achieve an estimate of lifetime credit losses.

- To estimate expected credit losses under CECL, institutions will use a broader range of data than under existing accounting standards. These data include information about past events, current conditions, and reasonable and supportable forecasts relevant to assessing the collectability of the cash flows of financial assets.
- While there are differences between today's incurred loss methodology and CECL, the agencies expect the new accounting standard will be scalable to institutions of all sizes and that smaller and less complex institutions will be able to adjust their existing allowance methodologies to meet the new accounting requirements without the use of costly and complex models.
- The agencies encourage institutions to plan and prepare for the transition to the new accounting standard, including assessing the potential impact on capital.
- Because appropriate allowance levels are institution-specific amounts, the agencies will not establish benchmark targets or ranges for the change in institutions' allowance levels upon adoption of CECL, or for allowance levels going forward.

The complete statement can be accessed at <https://www.fdic.gov/news/news/press/2016/pr16051a.pdf>.

## FINCEN PUBLISHED "CUSTOMER DUE DILIGENCE REQUIREMENTS FOR FINANCIAL INSTITUTIONS" FINAL RULES

The rules contain explicit customer due diligence requirements and include the new requirement to identify and verify the identity of beneficial owners of legal entity customers, subject to certain exclusions and exemptions. Banks will have to use Customer Identification Program procedures to verify the identity of beneficial owners, although when documentation is used, banks can rely on copies. The rule allows banks to rely on information provided by the customer.

Banks will be required to collect and verify the personal information on the beneficial owners who own, control and profit from companies when opening new accounts. Specifically, banks will be required to:

- Identify and verify the identity of the beneficial owners of companies opening accounts.
- Understand the nature and purpose of customer relationships in order to develop customer risk profiles.
- Conduct ongoing monitoring to identify and report suspicious transactions.

A beneficial owner is any individual who owns 25 percent or more of the equity in the entity, as well as individuals with significant responsibility to control or manage the entity. Persons with significant responsibility are defined as executive officers; senior managers, such as a CEO, CFO, COO, managing or general partner, etc.; or any other individual who regularly performs similar functions. If no individual maintains a 25 percent or more interest in the company, the financial institution will be required to identify only the executive officer, senior manager, or functional equivalent.

The identity of the beneficial owners must be certified to by either the legal entity or by the person opening the account for the entity. FinCEN included in the appendix

to the regulation a "Certification Regarding Beneficial Owners of Legal Entity Customers" form to be used.

After identifying the beneficial owners, each person's identity must be verified in the same manner as is currently done for new customers, i.e., obtaining documentation verifying the person's date of birth, address, and social security number. Then, in the same manner as for other customers, the identity and the identifying documents are to be recorded and documentation retained for five years after the account is closed.

Exceptions to the rule are banks, companies listed with the SEC, and many other categories of regulated entities.

Banks will now be required to include "appropriate risk-based procedures for conducting ongoing customer due diligence" in their anti-money laundering (AML) compliance programs. Specifically, these procedures must include, but are not limited to the following:

- Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile
- Conducting ongoing monitoring to identify and report suspicious transactions and to maintain and update customer information (including changes in beneficial owners of legal entity)

Banks are required to comply with the new requirement by May 11, 2018. This rule applies only to new accounts; there is no retroactive application of this rule to existing accounts.

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## **INTERAGENCY GUIDANCE: DEPOSIT-RECONCILIATION PRACTICES FIL 35-2016**

The banking agencies issued guidance to ensure that banks are aware of supervisory expectations regarding deposit-reconciliation practices that may be detrimental to customers.

This guidance addresses a set of situations in which customers make deposits to accounts and the dollar amount that the financial institution credits to that account differs from the total of the items deposited. Such discrepancies may arise in a variety of situations, including inaccuracies on the deposit slip, encoding errors, or poor image-capture.

For example, the customer may deposit \$110 to an account but may indicate on the deposit slip that only \$100 has been tendered. In this case, the financial institution may credit \$100 to the customer's account as indicated on the deposit slip, without reconciling the \$10. The result may be a detriment to the customer and a benefit to the financial institution if not appropriately reconciled.

Various laws and regulations may be relevant to deposit-reconciliation practices. Among them, Regulation CC requires that financial institutions make funds deposited in a transaction account available for withdrawal within prescribed time limits. In addition, a financial institution's deposit reconciliation practices are subject to Section 5 of the Federal Trade Commission Act, which prohibits a financial institution from engaging in unfair or deceptive acts or practices.

The agencies expect financial institutions to adopt deposit reconciliation policies and practices that are designed to avoid or reconcile discrepancies or designed to resolve discrepancies such that customers are not disadvantaged. Information provided to customers about the financial institution's deposit reconciliation practices should be accurate. Financial institutions should implement effective compliance management systems that include appropriate policies, procedures, internal controls, training, and oversight and review processes to

ensure compliance with applicable laws and regulations and fair treatment of customers.

## **MILITARY LENDING ACT (MLA) REMINDER**

Last year, the Department of Defense (DOD) passed the MLA, with a compliance effective date of October 3, 2016. The final rule extends the types of closed-end and open-end consumer credit products covered under the MLA to include those aligned with the definition of credit under Regulation Z, excluding only residential mortgages and vehicle purchase loans.

Under the MLA, a covered borrower is an individual serving on active duty in the military and their spouse and/or child(ren). To determine the borrower's status and thereby obtain a safe harbor, lenders may use one of the following two methods for conducting a covered-borrower check: 1) using information obtained directly or indirectly from the MLA database or 2) relying on information contained in a consumer report obtained from a nationwide consumer reporting agency. The lender will need to comply with recordkeeping requirements regarding the determination.

In addition to providing disclosures required by Regulation Z, a creditor will be required to provide a statement of the MAPR that describes the charges the creditor may impose but will no longer be required to provide the periodic rate of the MAPR and the total dollar amount of all charges included in the MAPR. The final rule provides a model statement describing the MAPR. A creditor may use the model statement or a substantially similar statement.

The creditor must also provide a clear description of the payment obligation, which can be satisfied by using a payment schedule or account-opening disclosure as required by Regulation Z. In addition to the written disclosures required, the creditor must provide the following: 1) the statement of the MAPR and 2) a description of the payment obligation orally. However, a creditor may now provide the oral disclosures either in

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person or by providing a toll-free number the borrower may use to obtain the disclosures. If the creditor elects to provide a toll-free number, it must include that number on the application form or with the statement of the MAPR.

### **QUESTIONS?**

If you wish to discuss these matters in detail, please contact Steve Zanardelli, Tim Schofer, or Frank Antiga at (724) 934-0344 or (800) 580-7738, or email [szanardelli@srsnodgrass.com](mailto:szanardelli@srsnodgrass.com), [tschofer@srsnodgrass.com](mailto:tschofer@srsnodgrass.com), or [fantiga@srsnodgrass.com](mailto:fantiga@srsnodgrass.com).