2012: A PREVIEW OF THE CONSUMER FINANCIAL PROTECTION BOARD

Ari Karen
Offit Kurman
akaren@offitkurman.com
917-312-2294
301-575-0340

Bill Heyman
Offit Kurman
wheyman@offitkurman.com
301-575-0393
• Warren is out
• Richard Cordray is in -- but when?
• Senate filibuster blocking nomination extract weakening provisions
• Eventually he will be nominated
• Possibility of recess appointment
Who is Richard Cordray

- Former Ohio Attorney General
- Made name for himself by taking on financial institutions
- Definitely consumer oriented
- Not a friend of the industry
Immediate Future

- Until CFPB has leader limited enforcement
- Common conception is no aggressive enforcement without leadership
- Mostly setting up policies, procedures, infrastructure and less controversial issues
- Taking aggressive action could complicate nomination process or hurt public opinion
- CFPB has already unveiled internet based and hotline access about lenders
- CFPB combining TILA and HUD 1 into single form intended to provide easier offer-actual mortgage comparison (50% reduction)
Consumer Complaints

- Will accept consumer complaints and obtain response from company. All responses must be copied to all regulators with oversight.
- Consumer can request supporting documentation.
Fair Lending and Equal Opportunity

- The CFPB will enforce fair lending laws including ECOA and HMDA
- The Bureau can declare any “unfair” practice unlawful if
  - causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers;
  - And practice is not outweighed by countervailing benefits to consumers or to competition.
Can declare Abusive practices illegal if:

- Takes disadvantage of consumers’ lack of understanding
- Consumer cannot protect themselves
- Consumers reasonably rely on the covered entities
Prohibited Acts

• Offer or provide and product or service not in conformity with federal laws
• Committing any act in violation of federal lending laws
• Engage in any unfair, deceptive or abusive act or practice
• Refuse to allow access to records; fail to maintain records;
• To knowingly or recklessly assist another in violation of the law.
• CFPB has already issued an enforcement guide
• While it is extremely vague and gives little guidance it specifically mentions disparate impact as theory it will proceed under
• Magler v. Gallagher. Fair Housing Act case applying disparate impact being reviewed by US Supreme Court.
Ability to Repay Analysis Will Be a Critical Factor Going Forward

• Dodd Frank 1411 amends TILA to require “ability to repay” determination

• (a) ABILITY TO REPAY.—

(1) IN GENERAL.—In accordance with regulations prescribed by the Board, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.

• Takes the HOEPA ability to repay requirement and expands it to all residential mortgage loans
What is the Impact

• Liability for steering to predatory loan, or for closing where consumer doesn’t have the ability to repay, or for steering to non QM

• Liability:
  – Violation is a defense to foreclosure
  – If not QM no prepayment penalty
  – Liability for actual damages or 3x compensation

• If QM presumption of non-liability. At this time, we just don’t know for sure what a QM will exactly look like but...
• Representative Scott Garrett (R) NJ asked to repeal risk retention. Rejected.
• Study found average down payment is about 12 percentage nationally. Most mortgages would not qualify
• 20% Rule appears dead but no one knows what if anything will take its place. Could be part of the negotiation for nominee.
Qualified Mortgage Criteria

- Cannot defer repayment of principle or allow periodic loan payments to result in principle increase
- Income/financial resources verified
- Payment schedules must account for taxes, insurance, HOA, etc.
- Total points and fees cannot exceed 3% of loan amount
- May not have balloon payment (2x average of earlier scheduled payments).
Qualified Mortgage Criteria

• Underwriting based on fully amortized loan at maximum rate permissible first 5 years
• Maximum loan term is 30 years
• Fed will publish rules pertaining to LTV, DTI, etc issuing terms or conditions necessary to satisfy requirements of QM
• Fed may relax requirements for smaller loan amounts, rural areas..
(3) BASIS FOR DETERMINATION.—A determination under this subsection of a consumer’s ability to repay a residential mortgage loan shall include consideration of the consumer’s credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer’s equity in the dwelling or real property that secures repayment of the loan.

A creditor shall determine the ability of the consumer to repay using a payment schedule that fully amortizes the loan over the term of the loan.
(4) INCOME VERIFICATION.

—A creditor making a residential mortgage loan shall verify amounts of income or assets that such creditor relies on to determine repayment ability, including expected income or assets, by reviewing the consumer’s Internal Revenue Service Form W–2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer’s income or assets.

In order to safeguard against fraudulent reporting, any consideration of a consumer’s income history in making a determination under this subsection shall include the verification of such income by the use of—

“(A) Internal Revenue Service transcripts of tax returns; or

“(B) a method that quickly and effectively verifies income documentation by a third party subject to rules prescribed by the Board.
A consumer's individual ability to repay uses eight criteria:

1. The income or assets the lender is relying on in making its decision;
2. The consumer's current employment status;
3. The mortgage's monthly payment;
4. The monthly payment on any other mortgages on the property, such as home equity lines of credit;
5. The monthly payment for all mortgage-related obligations;
6. The consumer's other current debt obligations;
7. The consumer's monthly debt-to-income ratio or residual income; and
8. The consumer's credit history.
Criteria Must be Verified

• Review consumer’s Internal Revenue Service Form W–2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer’s income or assets.
• Must review IRS Transcripts of Tax Returns for income history, or
• A method that quickly and effectively verifies income documentation by a third party subject to rules prescribed by the CFPB
• Numerous vendors provide third-party verification
Ensuring that ATR Requirement is Followed

• We recommend that if you haven’t done so already, make sure you have policies and procedures describing the necessity and how it should be performed. Training for LO’s is critical so that they do enough but don’t go too far.

• An example is ATR vs. Fair Lending. It’s a tight rope that needs to be walked at times.
Safe Harbor or Rebuttable Presumption

- Act is not clear about whether a QM provides a “safe harbor” a “rebuttable presumption”
- Safe harbor means exactly what it says – no worries if it is a QM
- Rebuttable presumption means that the consumer could rebut the presumption of a QM, and would lead to much more uncertainty and litigation
- Being unsure, Fed issued alternate proposals for QM, one for a “safe harbor,” one for “rebuttable presumption”
Dodd Frank Language on QMs

- May not exceed 30 years (limited exceptions)
- No negative amortization or interest only (no deferment or increase of principal)
- No balloon payments (limited exceptions)
- Verified and documented income and financial resources of consumer
- For fixed rate loans, underwriting based on schedule that fully amortizes loan (accounting for taxes, insurance and other assessments)
- For adjustable rate loans, underwriting based on maximum rate during first five years (accounting for taxes, insurance and other assessments)
- Points and fees (as defined) may not exceed 3 percent of the loan amount
- Specific requirements for reverse mortgages
Fed Safe Harbor Alternative

• Very similar to Act’s own language
• No negative amortization, interest only or balloon payments (with limited exception for balloon payments for smaller lenders in rural or underserved areas)
• Total points and fees cannot exceed 3% (except for smaller loans under $75,000)
• Consumer’s income and assets must be verified
• Underwriting must account for a payment schedule that fully amortizes the loan over its term using the maximum interest rate that could apply during the first five years and fully amortizes the loan over the loan term and takes into account mortgage-related obligations
• Mortgage related obligations include property taxes, special assessments, mortgage insurance, HOA and Condo Association fees, and ground rent or leasehold payments
Fed Rebuttable Presumption Alternative

Everything in Safe Harbor proposal, plus additional underwriting that considers and verifies:

– Consumer’s current or reasonably expected income or assets other than the value of the property securing the loan
– If lender relied on the consumer’s work income, the consumer’s current employment status
– Any other monthly payments on any simultaneous mortgages
– Consumer’s current debt obligations
– Consumer’s monthly debt-to-income ratio or residual income
– Consumer’s credit history
Other Ways to Meet ATR Requirement

• Meet the General ATR Requirements (and thus no limits on loan terms, risky features, fees and points)
• Operate in Predominately Rural or Underserved Areas and meet certain requirements
• Refinance a “hybrid” or “nonstandard” mortgage, i.e., an interest-only, negative amortization ARM with a fixed rate for a number of years into a “standard mortgage” which has limits on fees and is not interest only, does not have negative amortization, and has no balloon payment. All ATR factors must be considered except for the requirement to verify and consider the consumer’s income and assets, and the creditor must underwrite the mortgage based on the maximum interest rate that can apply in the loan’s first five years.
Loan Officer Duty of Good Faith

- Subject to additional regulation and laws to be created by CFPB
- Most likely will involve a form of watered-down fiduciary duty or a fiduciary duty created under “limited” circumstances
- Acting in the borrowers best interests
- Still uncertain and political outcome will determine
Whistleblower Policy is Critical

• People often do not want to deal with problems. But, given the new law, it is more critical than ever.

• Based on our experience with other laws with whistleblower provisions, such as FLSA and Title VII, not dealing with issues early and properly can lead to severe consequences.
Whistleblower Policy is Critical

• Now, under Dodd Frank, all Financial Services Industry professionals – including your employees – have whistleblower protection.
• Must have a clear anti-retaliation policy and culture.
• Must have a clear written policy and person responsible for compliance.
Policy and Procedure

- You must have a whistleblower policy that is written with Dodd Frank and state law in mind, and that is in every employee handbook.
- The policies are not one size fits all, and will change depending on the size of your organization and its needs.
- If you don’t have a policy vulnerable to phantom claims that "would have been reported if they knew how to"
- Shows noncompliance with law - bad way to start with judge or jury
- With policy can show lack of compliant by its absence
What Should a Policy Contain

• Dual reporting channels
• Clear no retaliation policy with serious repercussions, including termination, for retaliation
• One person at the organization ultimately responsible for whistleblower complaints
• Ability to register anonymous complaints
• An explanation of the types of misconduct that must be reported
Serious Consequences if Whistleblower Complaints are Not Handled Properly

- Employee whistleblower complaints will be reported to and investigated by the U.S. Department of Labor and may lead to an administrative hearing.
- If a party disagrees with the administrative decision, the case can be appealed to the appropriate federal district court, where it will be heard anew and proceed like any other federal statutory claim. This can be a costly and time consuming undertaking for any employer and the process itself can lead to broader and wider ranging investigations by regulators and the Department of Labor.
How to Respond to Complaint

- You must have a point person to take the lead in responding. S/he should:
- Call your HR attorney (in-house or outside counsel)
- Explain confidentiality to employee
- Have counsel run an investigation
- Decide what action to take if allegations are correct – case by case basis
- Critical for counsel to be involved for privilege purposes
- Have clear policy of documenting everything

© 2011 Offit Kurman, PA. All Rights Reserved.
• You cannot retaliate against an employee for reporting to you, to the CFPB, or any state or federal agency any action that involves a violation under the jurisdiction of the Bureau (basically, for our purposes, anything to do with residential lending). Dodd Frank 1057

• Testifying and objecting to or refusing to participate in any activity or task the employee reasonably believes violates a rule or law under the CFPB’s jurisdiction is also protected.
Clear Policies are Needed

Explaining that Steering is Prohibited

That Loan Fraud will not be Tolerated

Covering High Cost Loans

Appraisals

Discussing the Need for Ability to Repay

Analysis
Steering

• Discouraging a consumer from seeking a secured residential mortgage loan from another lender if you’re unable to offer a loan that is not more expensive than the proposed loan. In English - cant sell your company over competitor unless you match the price.
• Falsifying or mischaracterizing property values
• Falsifying or mischaracterizing a consumer’s credit history or the loans available to him
Steering

• Prohibits steering a consumer to a residential mortgage loan that:
  • He lacks the ability to repay
  • Has predatory characteristics (such as excessive fees)
  • To a non-qualified mortgage when eligible for a qualified mortgage, or
  • Reflects Abusive or Unfair lending practices (discrimination based on race, sex, ethnicity, or assets)
Steering

• Completely different from Reg Z Ammenment - no 3 loan beauty pageant required
• Unfortunately need to comply with both, so Dodd Frank adds responsibility
LO Comp:
Reg Z vs. Dodd Frank

• Differences between Federal Reserve Regulation and Dodd Frank
  – Broader definition of origination includes, taking application assists a consumer in applying or obtaining a loan, or offers or negotiates the terms of a loan.
  – Exclude processors (sort of) indicating that one who performs only administrative or clerical tasks is not an originator.
  – Excludes creditor
• originator can only receive an origination fee if it is either paid directly by the consumer or (assuming no compensation is paid by the consumer) there is no upfront payment by the consumer of discount points, origination points or fees (excluding bona-fide third-party fees).

• In English – no borrower comp an only can pay originator if fees are financed into transaction
• How many times do you think a LO for your company has told the appraiser, or indicated in some way, where the appraisal needs to be?

• They need to know that they can’t do that anymore and, if they do it, you need to have a procedure in place for discipline to occur – the risks to your company are too great to allow this to happen just so another loan can close.

• **NO AGREEMENT WITH AN APPRAISER, OR ANY MARKETING AGREEMENT FOR THAT MATTER, SHOULD EVER BE ENTERED WITHOUT REVIEW AND RECEIPT OF AN OPINION LETTER FROM COUNSEL**
You will have the HMDA Data – Use it
Federal law does not protect self-analysis of loan and application files
Only protects “new data,” such as fake mortgage applications used for testing and compliance.
The common law self-critical analysis privilege may apply, depending on where you’re located, but likely will not
In Connection with an Investigation

• Put Nothing in writing except if it is to counsel
• This includes texting, messenger service, and web communications
• All communications with counsel need to have warnings/disclosure that the information is privileged
• So, what we’re saying is, if you do self analysis and an attorney is not involved, what you do will likely be discoverable
HMDA – Currently Required

- Application/loan identification number.
- Date application received.
- Type of loan (e.g., FHA, conventional, etc.)
- Property type.
- Purpose of loan.
- Occupancy.
- Loan amount

THIS HAS NOT CHANGED AND WILL STILL BE IN EFFECT UNTIL THE ACT BECOMES EFFECTIVE AND CFPB ISSUES NEW RULES
HMDA – Currently Required

- If the loan requested is for a purchase, whether there was a request for preapproval.
- Type of action taken.
- Date of action taken.
- Property of location, in terms of metropolitan statistical area.
- Census tract number.
- Ethnicity of applicant.
- Race of applicant.

THIS HAS NOT CHANGED AND WILL STILL BE IN EFFECT UNTIL THE ACT BECOMES EFFECTIVE AND CFPB ISSUES NEW RULES
HMDA – Currently Required

- Gender of applicant.
- Income of applicant.
- Type of purchaser (to indicate whether a loan that your institution originated or purchased was then sold to a secondary market within the same calendar year).
- Reasons for denial.
- Rate spread between the APR and the applicable average prime offer rate.
- HOEPA status.
- Lien status.

THIS HAS NOT CHANGED AND WILL STILL BE IN EFFECT UNTIL THE ACT BECOMES EFFECTIVE AND CFPB ISSUES NEW RULES
Dodd Frank Adds the Following

FOR ALL COMPLETED LOANS:

– Itemization of the number and amount of loans by age.

– Itemization of the number and dollar amount of mortgages with respect to the total points and fees payable at origination for the applicable mortgage.

– The APR of the applicable loan must be compared to the benchmark rate of all relevant loans.

– Itemization of the term (in months) of any prepayment penalty.
FOR ALL COMPLETED APPLICATIONS

- Value of any real property pledged as collateral.
- Term of any introductory interest rate period.
- Term of the loan in months.
- Channel through which each application was made (e.g., wholesale, broker, etc.).
- Availability of the option to the borrower to adjust the payment schedule.
- Applicant's credit score.
What will be done with that Information?

In the case of mortgage bankers, CFPB will analyze data to:

- Determine how institutions are serving the housing credit needs of their communities.
- and help identify possible discriminatory lending patterns and assist regulatory agencies in enforcing compliance with antidiscrimination statutes.
- Your focus should be to analyze the data with respect to preventing and avoiding discrimination claims.
Plans for Self-Analysis

- Review HMDA Data Quarterly
- You can use Vendors to do regression analysis and also to assist with compliance -- easiest and, depending on your size, most cost-effective way.
- If smaller, you can analyze the Loan Application Register information yourself
Simple Self Evaluation Steps

- Sort HMDA data by census tract – this helps determine geographic dispersion of lending among various census tracts, including LMI tracts.

- Sort and review consumers by income, race, and sex – if data indicates disparities based on declined applications should lead to compliance review and the involvement of your attorney.

- See who is getting the High Cost Loans/non-QMs.

- Sample reported data with actual documents to check for errors in accuracy. If there is an issue, you need to handle it right away.
Best path is attorney-client privilege.
Data and analysis should be segregated in report.
Data would not be protected, but your internal analysis should be if it is posed to your lawyer (in-house or outside counsel) for purposes of obtaining legal advice.
No guaranty, but this is your best alternative.
Be Smart about Reports

Have Data analysis limited to one key persons (depending on your organization’s size). They should know:

– to keep comments to a minimum
– that not everything has to be in writing
– to be smart about what is said
• Many of our clients have asked us to audit their employee materials and training materials, and to speak with management about Dodd Frank compliance

• Whether we or another reputable firm does the audit doesn’t matter. What does matter is that if you don’t have the internal resources, an audit will ensure that your written materials are consistent with Dodd Frank provides an excellent, low cost way for
Audits

• For example, we’ve found that many clients did not have whistleblower policies, which, before Dodd Frank, we’re helpful but not absolutely necessary. And this is not something that can be pulled off the shelf.

• Is your employee handbook up to date?
Audits

• When you are faced with an investigation over fair lending, will you have (because you were told at audit), a systemic fair lending training procedure that makes clear that discrimination is not tolerated?

• Will you have internal reviews of HMDA data (thanks to implementing such reviews when suggested by audit) that can be used to defend the claims against you?
What you need to do

• Provide training to managers
• Provide separate training to LO’s
• Hire compliance staff (even if its external)
• Ensure you have adequate policies pertaining to fair lending, data maintenance and collection, employment policies, compensation, pricing, underwriting.
Your Responsibility to Train Your People

- It is your responsibility to train your company’s people to comply with the law
- Need clear policies and procedures written in laymen’s terms/not legalese
- Need to review your employee handbook to ensure that all necessary areas are covered
- Need a corporate culture in which, depending on your company’s size, the training and compliance functions are clearly delegated to competent high-level employees
- Need to use your counsel and not be penny-wise and pound foolish

© 2011 Offit Kurman, PA. All Rights Reserved.
LOs and Managers Must Be Familiar with the Law

• Dodd Frank even further regulates an already highly-regulated industry.

• You must have training to ensure that your LOs and Managers know what they can, and cannot do.

• This should be in the form of written materials and training/monitoring by HR and/or compliance
Training Managers

- Anti-retaliation for whistleblowers
- Ability to repay
- Anti-steering requirements
- What you can say to a borrower and when (about competing offers)
- Fair lending vs. ability to repay
- Duty to act in good faith
- What is “originating”
Training LO’s

• Zero Fraud
• What is ability to repay analysis
• What is duty to act in good faith
• Fair lending
Compliance Person’s Duties

• Collecting and being responsible for data
• Answering Inquiries from regulators (with counsel)
• Preparing reports
• Being available for counsel
• Handling court-related issues (with counsel)
• Interacting with auditors
THANK YOU

Ari Karen
Offit Kurman
akaren@offitkurman.com
917-312-2294
301-575-0340

Bill Heyman
Offit Kurman
wheyman@offitkurman.com
301-575-0393