NEWS

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CFPB Focus

EXPAND YOUR EXPECTATIONS℠

October 2013

Heard on the Phone

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There's much chatter over the phone and face-to-face these days about the more strenuous rules and regulations being imposed in the wake of the recent banking and mortgage crises. We take a look at some of the most-discussed issues.

As trusted advisors, that is, lawyers (no lawyer/shark jokes please, but did you hear the one about...), to many financial institutions, we spend much of our day on digitally enhanced telephones or other devices communicating with our clients. With our financial institution clients, we are spending an increasing amount of our time discussing regulatory issues, including consumer compliance and examination issues now overseen on the federal level by the Consumer Financial Protection Bureau (CFPB). Below we highlight real stories and conversations.

- **Examinations**. Bankers view as a heightened level of antagonism the fact that CFPB examiners are bringing enforcement personnel and attorneys with them to onsite examinations. Financial institutions are not used to this level of confrontation and anxiety during "safety and soundness" or even traditional compliance exams. After numerous complaints and even the recommendation of the CFPB's own Ombudsman, the CFPB announced October 10 that these enforcement folks will no longer be physically present, but will still coordinate with examiners offsite. The Deputy Director of the CFPB, in an apparent face-saving effort, indicated on October 16 that the CFPB is not bowing to the requests of bankers nor his own Ombudsman, but that the change is a result of increasing the efficiency of the exam process.

- **Board Duties**. Some of our clients have indicated that CFPB examiners have been more interested in Board of Directors' involvement in compliance training and policy writing than actual implementation of consumer protection. One example is a situation in which, previously, the first document requested by an examiner might have been Home Mortgage Disclosure Act data, but now they are asking for the Board's implementation plan for qualified mortgages (QM), and rarely is the plan found to be acceptable. This interest in the directors' roles may be an attempt to expand the fiduciary duties of directors and then provide examiners an easier way to threaten directors when there is a perceived violation.

- **Training**. While most of the CFPB examiners may have worked previously at a financial institution or even at a regulatory agency, most were not involved as examiners, especially consumer compliance examiners. Many worked in accounting or even at trading desks, which does not necessarily give them the experience they need. Most of the examiners seem to admit to their lack of training, are very professional about their limitations, and even ask for help from the institutions they are examining.

- **Level the Playing Field**. The Deputy Director of the CFPB has indicated, and the examiners in the field agree, that one of their roles is to "level the playing field" between bank and non-bank lenders. This may be an unfair position from a practical standpoint, when small non-bank or even small bank lenders have limited resources to implement all the requirements being imposed.

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- **Policies**. Policies, as indicated above, are critical to CFPB examiners. They need to be in writing, reviewed often, include items addressed in CFPB guidance manuals, and be easily accessible and useable by all employees. A formal training program for employees is encouraged. A system to keep policies up-to-date with changing rules and interpretations is necessary.

- **Details, Details**. On October 9, we participated in a teleconference of the American Bar Association's Housing Finance Subcommittee of the Consumer Financial Services Committee, where attorneys for the CFPB discussed the CFPB's mortgage rules. They confirmed that the implementation date of January 10, 2014, is not expected to be extended. The general tone of the call was that the rules are extremely hard to interpret even by sophisticated CFPB and outside attorneys, and many formal interpretative measures will be needed. Some issues about the rules discussed:
  - The practice of compensating a non-producing branch manager based on mortgage volume does not in itself make the manager a loan originator, subject to particular compensation limitations.
  - CFPB's new QM definition is not consistent with FHA's proposed definition. The CFPB lawyer said when the FHA rule goes into effect, the CFPB's definition expires, so there would be no conflict.
  - If a loan originator is paid based on volume, but the basis of the volume calculation varies depending on whether the originator meets certain yield criteria set by the lender, is this possibly "steering" the borrower and therefore not allowed? It depends on how much control the originator has over steering.
  - The CFPB is aware that there have been many questions raised about a servicer being required to make disclosures about the loan's owner, and they have not resolved these issues. Stay tuned.
  - How does a borrower provide statements when he is in bankruptcy and the court frowns on this disclosure? This and many other bankruptcy issues will be addressed by the CFPB in the near future. [The CFPB issued an interim final rule on this issue on October 15.]
  - If a borrower asks a servicer to complete a short sale, is the servicer required to evaluate a borrower for all loss mitigation options? Yes, but this can be handled easily if the servicer's criteria begins with the question as to whether the borrower wants to stay in his home, and if the answer is no, then the short sale can be addressed quickly.
  - Balloon loans will not be QMs with the exception of a 2-year transition rule for roll-overs for small creditors, and for certain other small creditors even after the 2-year period. The CFPB intends to reexamine the rules after the 2-year period.
  - What if a GSE (Government-Sponsored Enterprises; i.e., Fannie Mae, Freddie Mac, etc.) purchases an eligible QM loan but later requires a repurchase? The loan does not lose its government-backed mortgage status, since that is determined when the loan is purchased by the GSE originally.
  - The lender is required to provide a list of counselors to borrowers. The Department of Housing and Urban development (HUD) has a list, but CFPB does not. The lawyers said a list will be posted "relatively soon," so do not worry about the HUD website list. He said they are trying to get the list out soon enough to give lenders time to implement technological changes to implement the requirement.
  - When will examinations on the new rules begin? The CFPB Director gave a speech on September 11, 2013, that "good faith" compliance with the rules is what will be reviewed, and early exams will take reasonable compliance implementation time challenges into consideration.

These and other questions addressed can be reviewed here.

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- **Contradiction**. Earlier this summer, some of our partners visited the CFPB's newly renovated headquarters at 1700 G Street in Washington, along with other representatives of the Tennessee Bankers Association. Senior staff of the CFPB responded to questions from bank presidents. The general response to the question of "why" with respect to a number of rules proposed at that time was that the CFPB had its hands tied by legislative requirements imposed by Congress. When the same bank delegation met with its Congressmen, many Congressmen indicated that they felt the legislation left enough leeway in the hands of the CFPB to avoid overburdening the banks and their ability to lend. This contradiction is what those of us who are D.C. "outsiders" always seem to question about the workings within the beltway.

- **Responsibility for Acts of Customers**. In correspondence between the CFPB and Democratic members of Congress, the CFPB has indicated that it may sue banks for lending arranged by car dealers, who otherwise fall outside the CFPB jurisdiction, if such loans are deemed to be discriminatory. The Congressmen have asked the CFPB for details about its policy and the extent it may extend beyond auto loans (such as has also been evidenced by actions against lenders providing services to payment processors). Even though the CFPB has attempted to respond, the Congressmen indicate they have not been satisfied that their specific questions have been addressed.

- **Enforcement**. Although Dodd-Frank exempts banks with under $10 billion in assets from direct exams by the CFPB, the CFPB has been involved in joint enforcement actions and restitution orders with the smaller institutions' primary federal regulators.

- **Quick Reference Chart**. The CFPB has released a chart helping lenders understand whether they qualify as small creditors under the QM rules, and addressing other questions about the rules.

- **Fines**. To flex its muscles and show the industry it is serious about Home Mortgage Disclosure Act (HMDA) compliance systems and data errors, the CFPB on October 9 fined a bank and a mortgage lender, and it warned a number of other institutions on issues of inaccurate information reporting under HMDA. The bank, in particular, has publicly expressed its disappointment with the language of the CFPB's press release on the matter, which involved very technical compliance interpretations.

- **Principle-Based Enforcement**. At the SNL Bank M&A Symposium held in New York October 2-3, industry representatives indicated that enforcement of CFPB rules will be "principle-based." In other words, even if an institution is in technical compliance with a rule, CFPB examiners have the authority to broaden their enforcement if a bank's actions do not meet the principles which serve as the basis for the rules.

New QWR Requirements Under the CFPB

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The new year will be bringing many new changes to the mortgage servicing industry. In perhaps one of the most significant but least talked about changes, mortgage servicers will be facing several newly modified statutes regarding qualified written requests (more commonly known as QWRs) under the Real Estate Settlement Procedures Act (RESPA).

Consistent with the overall theme of the Dodd-Frank Act, Section 1463(c) will modify RESPA to allow borrowers to obtain faster responses to their QWRs as well as to impose heftier damages for a servicer's failure to respond. In fact, the timeframe for acknowledging and responding to QWRs will decrease significantly, and the allowable statutory damages for a QWR violation will double.

Section 1463(c) goes into effect on January 10, 2014, and will contain three noteworthy modifications to the QWR statute:

- First, a mortgage servicer's timeframe in which to acknowledge receipt of a QWR will change from 20 days to 5 days (excluding public holidays, Saturdays and Sundays). Essentially, a mortgage servicer will have five business days in which to acknowledge, in writing, its receipt of a borrower's QWR – as opposed to the 20 days previously allowed.

- Second, a servicer will have only 30 days (excluding public holidays and weekends) to provide a substantive, detailed response to the QWR – as opposed to the 60 days previously allowed.

- Third, servicers will be able to obtain an extension of time in which to respond to a QWR. According to the brand new rule 2605(e)(4), a servicer can now obtain a 15-day extension to the 30-day period in which to respond a QWR. The only thing a servicer must to do to receive the extension is notify the borrower of the extension and provide the reasons for the delay in responding. Even with the extension, however, servicers will have a maximum of 45 days in which to substantively respond to a borrower's QWR.

In addition to the tighter timeframe for responding to QWRs, the statutory damages available to a borrower will increase sharply. As of January 2014, an individual borrower may obtain statutory damages, in additional to actual damages, of as much as $2,000. Prior to the Dodd-Frank amendment, statutory damages available for a servicer's failure to respond to a QWR in a timely manner were capped at $1,000. Furthermore, in the case of a class action lawsuit, the maximum allowable amount of statutory damages available will double from $500,000 to $1 million.

CFPB Refines Mortgage Rules to Resolve Conflicts and Inconsistencies

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On October 15, 2013, the Consumer Financial Protection Bureau (CFPB) issued an interim final rule[1] and bulletin[2] refining and making technical changes to certain provisions of its January 2013 mortgage rules. The interim rule addressed three areas of concern: (1) the conflict between the servicing rules and protections afforded to consumers by bankruptcy law and the Fair Debt Collection Practices Act (FDCPA); (2) "early intervention" requirements for delinquent borrowers; and (3) policies which guide identification and evaluation of, and communications with, a deceased borrower's heirs.

The public has 30 days to provide comments on the amendments to the mortgage servicing rules upon publication of the amendments in the Federal Register.[3] After considering the public comments and adjusting the rules accordingly, the final form of these amendments will take effect with the mortgage servicing rules on January 10, 2014.[4]

Rule Changes and Guidance on Bankruptcy and FDCPA

The interim rule is intended to resolve concerns raised by mortgage servicers and bankruptcy trustees on how to comply with the servicing rules governing loans involved in Chapter 11 bankruptcy proceedings, and loans where the servicer is subject to the FDCPA and the borrower has sent a "cease communication" notice under 12 U.S.C. § 1692c(c). The CFPB proposes to resolve the conflict between complying with the cease notice and the servicing rules' notice requirements established by bankruptcy law by exempting servicers from both the periodic statements and the early intervention requirements for borrowers who have filed for bankruptcy.

Yet, certain communications are still required even when a borrower simply provides a general "cease communications" request: notices regarding initial interest rate adjustment of adjustable-rate mortgages, information requests, error resolution, requests for loss mitigation, lender-placed insurance and periodic statements. The following table summarizes the CFPB's conclusions on the interplay between the mortgage servicing rules, bankruptcy law and the FDCPA.

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[1] Bureau of Consumer Financial Protection, Interim Final Rule, Amendments to the 2013 Mortgage Rules under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z)(October 15, 2013), http://files.consumerfinance.gov/f/201310_cfpb_mortgage-servicing_interim.pdf (publication in the Federal Register forthcoming) ("Release").

[2] CFPB Bulletin 2013-12, *Implementation Guidance for Certain Mortgage Servicing Rules* (October 15, 2013), http://files.consumerfinance.gov/f/201310_cfpb_mortgage-servicing_bulletin.pdf ("Bulletin").

[3] Release at 1.

[4] *Id.* at 11.

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Mortgage Servicing Rules	Borrower Filed for Bankruptcy	Borrower Sent "Cease Communications" Notice
Error Resolution Procedures (12 C.F.R. § 1024.35)	No exemption from servicing rules	Must comply with servicing rules unless borrower specifically withdraws error notice[5]
Requests for Information (12 C.F.R. § 1024.36)	No exemption from servicing rules	Must comply with servicing rules unless borrower specifically withdraws "cease communication" request[6]
Force-Placed Insurance (12 C.F.R. § 1024.37)	No exemption from servicing rules	No exemption from servicing rules[7]
Early Intervention Requirements (12 C.F.R. § 1024.39)	Exempt from servicing rules once bankruptcy petition is filed until the case is dismissed or closed, or borrower receives a discharge[8]	Exempt from serving rules[9]
Loss Mitigation Procedures (12 C.F.R. § 1024.41)	No exemption from servicing rules	Must comply with servicing rules unless borrower specifically withdraws request for loss mitigation[10]
ARM Payment Adjustment Notice (12 C.F.R. § 1026.20(c))	No exemption from servicing rules	Exempt from serving rules[11]
ARM Initial Rate Adjustment Notice (12 C.F.R. § 1026.20(d))	No exemption from servicing rules	No exemption from servicing rules[12]
Periodic Statements (12 C.F.R. § 1026.41)	Exempt from servicing rules once bankruptcy petition is filed until the case is dismissed or closed, or borrower receives a discharge[13]	No exemption from servicing rules[14]

[5] Bulletin at 6 – 7.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] New 12 C.F.R. § 1024.39(d)(1); Cmts. 39(d)(1)-1 through -3, Release at 44 – 46.
[10] Bulletin at 6 – 7.
[11] New 12 C.F.R. § 1026.20(c)(1)(ii)(C) Bulletin at 6.
[12] Bulletin at 6 – 7.
[13] New 12 C.F.R. § 1026.41(e)(5); Cmts 41(e)(5)-1 through -3.
[14] Bulletin at 6 – 7.

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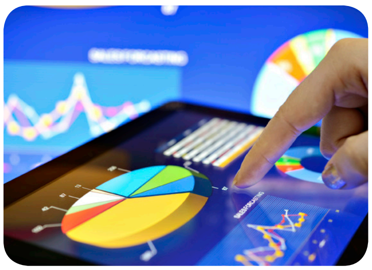

The CFPB, however, did not go so far as to analyze when bankruptcy law or the FDCPA may prohibit certain communications required by the servicing rules. Instead, it encouraged servicers to continue communicating with delinquent borrowers even in instances when compliance with the servicing rules is not required.[15] Further analysis of the interplay between the servicing rules and the FDCPA is expected in an upcoming rulemaking on debt collection.[16]

Early Intervention Guidance (12 C.F.R. § 1024.39)

The Bulletin additionally provided guidance on how a servicer can comply with the early intervention requirements of the servicing rules to establish live contact with the borrower. Once the rule goes into effect, for each billing cycle in which a borrower is delinquent for at least 36 days, servicers are required to make good faith efforts to establish live contact with the borrower by the 36th day and, if appropriate, to inform the borrower about the availability of loss mitigation options.[17] While the Bulletin provided specific guidance, the CFPB acknowledged that contact methods should be tailored to the particular circumstances, and, thus, the rule is designed to give servicers flexibility in developing and implementing communication processes.[18]

To clarify the CFPB's expectations, the Bulletin provided illustrative examples of what the CFPB would consider "reasonable steps" to reach delinquent and unresponsive borrowers. For example, in cases where a borrower falls delinquent under a loss mitigation plan or becomes delinquent after curing a default, the servicer must resume efforts – telephone calls and written communications – to contact the borrower within 36 days of the delinquency and continue those efforts so long as the borrower remains in default.[19] Nevertheless, after six or more consecutive delinquencies, "good faith" efforts may consist of no more than a single telephone call or a sentence in a periodic statement or other written communication asking the borrower to contact the servicer.[20] Such minimal efforts, the CFPB advised, should be limited to circumstances where all loss mitigation options have been exhausted and there is little to no hope of home retention.[21] Additionally, servicers may meet the live contact requirement by establishing and maintaining on-going communications with a delinquent borrower regarding the borrower's loss mitigation application or the servicer's evaluation of that application. The CFPB also explained that the live contact requirement may be satisfied by piggy-backing "good faith" efforts onto other communications with the borrower, such as adding information on loss mitigation options to collection calls or including a sentence in a written communication requesting that the borrower contact the servicer.[22]

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[15] *Id.* at 16, 19, 22 and 31. The CFPB "believes that further study of these issues is warranted but cannot be concluded quickly enough to provide further calibration of the requirements before January 2014." *Id.* at 16.
[16] *Id.* at 20 and 22.
[17] 12 C.F.R. §1024.39(a)
[18] Bulletin at 4 – 4 and n. 16.
[19] Bulletin at 5- 6.
[20] *Id.*
[21] *Id.*
[22] Bulletin at 5.

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Policies and Procedures Regarding Successors in Interest (12 C.F.R. § 1204.38(b)(1)(vi))

The final area in which the CFPB provided clarification pertain to a servicer's responsibility under the mortgage servicing rules to develop and implement home retention efforts after a borrower dies. Policies and procedures must be in place to ensure that family members, heirs or other parties with a legal interest in the property are promptly identified and contacted.[23] According to the Bulletin, after a borrower's death is confirmed, sufficient home retention efforts would be designed to promptly identify the borrower's successor in interest and provide the successor with information on the current status of the mortgage.[24] Servicers must then provide a successor with any documents, forms or other materials that are needed to allow the successor to continue making payments on the mortgage and, where appropriate, for servicers to evaluate the successor for loss mitigation options or assumption of the mortgage.[25]

Clearly, these refinements to the mortgage servicing rules are intended to increase the rate of home retention by family members or other heirs after the death of borrowers. Yet, because many successors in interest are likely to be unable to qualify for assumption – given the CFPB's current application of the ability-to-repay rule to assumptions – these efforts may not succeed.

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23 12 C.F.R. § 1204.38(b)(1)(vi).
24 Bulletin at 1 – 4.
25 Id.

Financial Institutions and Employers Cannot Mandate that Wages be Deposited to Payroll Card Accounts

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New Rule for Payroll Card Accounts

Payroll card accounts have many benefits. The cards are a helpful option for employees who do not have checking accounts, and many banks have offered financial incentives to employers who choose their institution's card to pay employee wages. The cards allow employees to pay bills online and utilize the cards like regular debit cards. The cards may also help the employees avoid the fees charged by check cashing businesses.

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Financial Institutions and Employers Cannot Mandate that Wages be Deposited to Payroll Card Accounts, *continued*

But, employers and financial institutions must both be mindful that the Electronic Fund Transfer Act and Regulation E (which implements the Act) apply to payroll card accounts. In a memo issued on September 12, 2013, the CFPB clarified that employers cannot require employees to receive their wages by electronic transfer to a payroll card account at a particular institution. Just as employers cannot mandate that an employee receive direct deposit wages at a particular institution, employers cannot mandate that wages be received on payroll cards (although the cards may be offered to employees as a choice). Banks must be mindful of this rule when formulating agreements with employers; the agreements cannot require the employer to use payroll card accounts as the sole wage payment option.

The CFPB memo follows negative press reports and Congressional concerns about high and/or undisclosed fees associated with payroll cards. The CFPB noticed that payroll cards may have their own fees. While purchases do not generally incur a fee, the employee may be charged a fee for ATM withdrawals, monthly maintenance, balance inquiries, and lost cards. The CFPB may also be concerned with the commissions that employers might receive from banks for each employee who signs up for a card.

Pennsylvania plaintiffs recently filed a class action lawsuit against the franchisee of several McDonalds restaurants, challenging the restaurants' requirement to receive wages on payroll card accounts. The McDonalds defendants defended their position by saying that the cards were like cash or a paper check. Now that the CFPB has been explicit on the topic, businesses cannot defend the practice with this rationale.

Employers may continue to offer the cards as an option, but they must also offer employees the option to receive wages in more traditional ways: direct deposit to an institution of the employee's choosing, paper check, or cash. And, even when the cards are offered only as an option, employers and banks must be careful to comply with state laws. Some states require that employees be paid their wages in full each pay period, and some states mandate free withdrawals or certain disclosures about the fees associated with these cards. Finally, if an employer chooses to offer the cards as an option, the employer and the banking institution must also be careful to comply with other consumer protection laws, such as disclosures, access to account history, and error resolution rights.

CFPB Enforcement Authority

The CFPB has authority to file actions in federal court for violations of the laws within its purview. When a person or company violates a federal consumer financial protection law, the Bureau can bring an enforcement proceeding against them. If that person or company is found to have violated the law, it may have to pay a civil penalty, also known as a civil money penalty. The funds are paid into a Consumer Financial Civil Penalty Fund, which is to be used to pay victims of such violations, as well as for financial literacy and consumer education programs.

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Financial Institutions and Employers Cannot Mandate that Wages be Deposited to Payroll Card Accounts, *continued*

On May 30, 2013, the Bureau allocated $488,815 to the eligible class of victims in the Payday Loan Debt Solution, Inc. case, approximately $10,000,000 to the eligible class of victims in the Chance Gordon et al. case, and $13,380,000 to consumer education and financial literacy programs. The CFPB also houses the Office of Administrative Adjudication (OAA), an independent judicial office. Administrative Law Judges in the OAA hold hearings and decide on formal charges and actions initiated by the Bureau. The charges and actions initiated by the Bureau are based on alleged violations of federal statutes and the regulations that carry out the statutes' mandates.

Financial institutions must be careful going forward that payroll card accounts created in conjunction with employers comply with the Electronic Fund Transfer Act and Regulation E, as well as with state laws.