

Thoughts on the Remarks of CFPB Deputy Director Antonakes at the MBA Servicing Conference

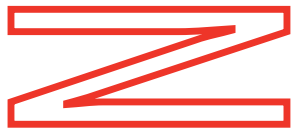
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As I sat in an Orlando convention center ballroom last week, I noted that the sense of anticipation for the remarks of CFPB Deputy Director Steven Antonakes seemed to range from “not that interested” to “just trying to get a sense of what’s next from the Bureau.” As Mr. Antonakes took the stage, attendees were still streaming in following the warm remarks of Bill Cosgrove, 2014 Chairman-Elect of Mortgage Bankers Association, and David H. Stevens, President and Chief Executive Officer of Mortgage Bankers Association. It was soon evident that many of the attendees had not expected to be on the receiving end of the candidly harsh tone Antonakes employed during his speech. “Nearly eight years have passed and I remain deeply disappointed by the lack of progress the mortgage servicing industry has made,” Antonakes said. Citing the number of foreclosures and homeowners still under water with their mortgages, Antonakes did not shy away from pointing the finger directly at the servicers filling the audience before him. “This kind of continued sloppiness is difficult to comprehend and not acceptable. It is time for the paper chase to end,” said Mr. Antonakes. Noting that he did not expect a standing ovation from the crowd, Mr. Antonakes certainly did not receive one.

Fortunately, for those in attendance willing to seek it out, commentary at other sessions of the conference appeared to demonstrate that the CFPB was willing to work with servicers going forward rather than simply laying the blame on them for problems in the past. Kelly Cochran, CFPB Assistant Director for Regulations, emphasized that the Bureau was indeed in a transition period from implementing new rules to monitoring and refinement of those rules. She noted that rulemaking was continuing and that the expectation was for debt collection in general to be an ongoing focus of the Bureau. CFPB Program Manager for Mortgage Servicing, Allison Brown, served on the panel for a session entitled “Lessons from the Industry on CFPB Servicing Exams.” Ms. Brown stated that a high number of consumer complaints received by the Bureau still related to mortgage servicing and that the Bureau’s 320 examiners were continuing to find serious problems. She discussed an ongoing issue with the transfer of servicing rights for loans with an approved loan modification in place and subsequent issues with the new servicer honoring the terms of the modification. Despite her concerns, Ms. Brown urged attendees to work with the CFPB in crafting or modifying regulations, and she seemed to express a genuine willingness to work with servicers.

Mr. Antonakes’ comments have been circulated far and wide in the industry. There is still much uncertainty as the CFPB moves into enforcement mode. The message at the MBA Servicing Conference seemed to be that the time is now for servicers to refine their compliance management, and they should not expect the scrutiny to fade anytime soon.



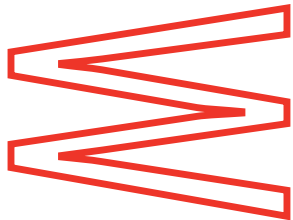
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First Enforcement Action of “Operation Choke Point”

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In a move that has since stirred up controversy on Capitol Hill, the United States Department of Justice (DOJ) in January filed an enforcement action and entered into a consent order with Four Oaks Bank & Trust Company, a small North Carolina bank, for what the Justice Department termed the “use of [Four Oaks’] accounts and its access to the national banking system in furtherance of a scheme to defraud consumers.”



According to the Complaint, Four Oaks entered into an agreement with a third-party payment processor granting the processor direct access to the Federal Reserve Bank of Atlanta, a clearing house for Automated Clearing House (ACH) transactions. Pursuant to the arrangement, the processor processed more than \$2.4 billion in transactions for its merchant customers. The vast majority of the transactions processed were for internet payday lenders. Other transactions involved alleged internet gambling and an alleged Ponzi fraud scheme. The DOJ further alleged that Four Oaks was aware of the fraudulent nature of the ACH transactions as it received substantial numbers of authorization verification requests from the borrower’s banks as well as high numbers of chargebacks, or transaction reversals (including a transaction return rate that was allegedly 21 times higher than the industry average). The DOJ concluded that this arrangement violated the requirement found in the Bank Secrecy Act and the USA Patriot Act that Four Oaks have procedures in place to prevent it from providing access to the national banking system to entities engaged in unlawful activity.

According to news reports, Four Oaks agreed to pay a civil penalty of \$1 million and to forfeit \$200,000 to the United States Postal Inspection Service’s Consumer Fraud Fund as proceeds of the fraud alleged in the lawsuit. In addition, the bank is required to assist the federal government in potential criminal investigations arising from the allegations, must commission an independent review of its conduct and must meet specific requirements before it can contract with any third party processors in the future. Specifically, Four Oaks cannot work with any processor that has, in the prior two years, serviced an internet payday lender that has generated transactions in excess of specified return thresholds. Further, Four Oaks must conduct due diligence to verify that any processor is not engaged in any false or deceptive business practice.

The Four Oaks lawsuit is the first enforcement action in the operation the DOJ entitled “Operation Choke Point,” a joint action between the DOJ, the Federal Deposit Insurance Corporation and the CFPB to crack down on banks that facilitate allegedly abusive online businesses, including certain online payday lenders. The DOJ issued subpoenas in the Spring of 2013 to more than 50 banks and third-party payment processors in furtherance of the initiative. Additional civil enforcement actions are expected.



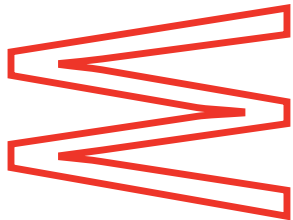
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First Enforcement Action of “Operation Choke Point,” *continued*

After the Four Oaks enforcement action was announced, Representatives Darrell Issa (R-Calif.) and Jim Jordan (R-Ohio), chairs of the House Oversight and Government Reform Committee and the Economic Growth Subcommittee respectively, sent a letter to Attorney General Eric Holder accusing the DOJ of abusing its power in Operation Choke Point. In the letter, Issa and Jordan contended that “the extraordinary breadth of the Department’s dragnet prompts concerns that the true goal of Operation Choke Point is not to cut off actual fraudsters’ access to the financial system, but rather to eliminate legal financial services to which the Department objects.” Issa and Jordan also requested that the DOJ provide records related to the initiative. According to news reports, a spokesman for the DOJ indicated that the Department would respond to the letter.



CFPB’s First Consent Order of 2014 Addresses RESPA Section 8(a) Kickback Scheme

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Consumer Financial
Protection Bureau

The Consumer Financial Protection Bureau (CFPB) issued its first enforcement order of 2014 against a St. Louis mortgage lender, Fidelity Mortgage Corporation (FMC), and its president, Mark Figert. The January 16 consent order resolves CFPB’s *threatened* administrative proceeding against the two Respondents stemming from its investigation of the alleged “kickback” scheme between FMC’s predecessor, Fidelity Financial Mortgage Corporation (Fidelity), and an unnamed Missouri bank.

According to CFPB, the Missouri bank began outsourcing its residential mortgage lending business in early 2010 to Fidelity, which at that time was owned and managed by Figert. Under their outsourcing arrangement, the bank referred to Fidelity all of its customers who were seeking a residential mortgage loan. Fidelity leased office space within the bank’s facility to handle the referrals and all referrals were originated for the bank. In lieu of a fixed rent payment for use of the bank’s office space, Fidelity’s “rent” was tied to the volume of loans that Fidelity closed from the bank’s referrals; i.e., the higher the volume of new loan originations, the higher the “rent” payable to the bank.

For the nine-month period from March 2012 through November 2012, CFPB found that Fidelity’s “rent” payments averaged \$1,350 per month as compared to market rent of \$600-900 per month for the same or similar office space. Thus, using CFPB’s figures, Fidelity paid the bank on average between 150% and 225% of the true market rent for use of the bank’s office space, with excess rent amounting to a “kickback” for mortgage loan referrals in violation of Section 8(a) of the Real Estate Settlement Procedures Act (RESPA).

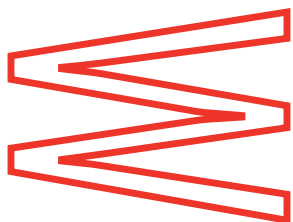


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CFPB's First Consent Order of 2014 Addresses RESPA Section 8(a) Kickback Scheme, *continued*



RESPA Section 8(a) prohibits the payment of any “fee, kickback, or thing of value” in return for the referral of business related to real estate settlement services.¹ Violations are subject to both criminal and civil penalties. There are specific exceptions in Section 8(c), including one for “the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.”² Here, however, CFPB drew from a June 1996 policy statement from the Department of Housing and Urban Development to determine that a significant portion of Fidelity’s “rent” was merely a “disguised referral fee” in an attempt to circumvent Section 8(a).



CFPB Director Richard Cordray describes this type of arrangement as “hampering fair market competition” and “unnecessarily increasing the cost of getting a mortgage.” Under the consent order, Fidelity and Figert agreed to pay \$81,076 for their roles in the scheme.³ This sum includes disgorgement of \$27,076 in origination fees that Fidelity earned from the kickback scheme plus a \$54,000 civil penalty. Additionally, Figert and Fidelity agreed to a broad injunction prohibiting them from violating RESPA Section 8 in the future, subject to additional monetary penalties.

The Bank of Sullivan acquired Fidelity’s assets in 2012 and now owns FMC. The Bank of Sullivan’s President and CEO, Mike Hoffman, discussed the consent order in a recent press release: “The cost of defending a claim made by the Federal government is too much for a small financial institution to afford. Therefore we decided that it was in the best interests of Fidelity to settle the claim.”⁴

In a press release associated with the January 16 consent order, Cordray commented that “[t]he Consumer Financial Protection Bureau will continue to take action against schemes that steer consumers to lenders through unscrupulous and illegal business practices.” CFPB’s January 16 consent order and the related press releases reveal several economic realities for banks and other financial institutions in the mortgage lending arena. On the one hand, CFPB continues to demonstrate its commitment to investigating and pursuing potential violations of consumer finance laws regardless of scope or magnitude. Still, those institutions that become targets of a CFPB investigation may often choose a consent order over protracted litigation as the less expensive and less time-consuming alternative, particularly when an adverse result in litigation may include severe penalties.

¹ 12 U.S.C. § 2607(a).

² 12 U.S.C. § 2607(c)(2) (emphasis added).

³ Fidelity is ordered to pay the entire sum. Figert is jointly liable for the \$54,000 penalty.

⁴ Lisa Brown, Fidelity Mortgage Fined Over Referral Arrangement, Jan. 17, 2014, http://www.stltoday.com/business/local/fidelity-mortgage-fined-over-referral-arrangement/article_86abc20a-45dd-542f-9042-409a9fb6f0c7.html



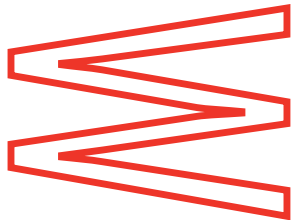
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CFPB Focusing on Mortgage Closing Process

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Following an initial focus on altering loan qualification guidelines and servicing regulations, the Consumer Financial Protection Bureau (CFPB) has turned its attention to the loan closing process for home mortgages. Specifically, the Bureau recently sought public comment regarding perceived problems or issues encountered by consumers at closing. It is widely expected that the Bureau will use the information to issue new regulations for the various steps of the mortgage closing process.

While one can only guess at what the exact regulations will entail, an examination of the questions posed by the CFPB gives a hint at potential areas of focus. The Bureau listed 16 specific questions about closings and the steps leading up to the closing, the various types of errors and changes that occur, involvement of third parties, and the types of paperwork involved in documenting and closing a loan. The specific questions posed by the Bureau are as follows:

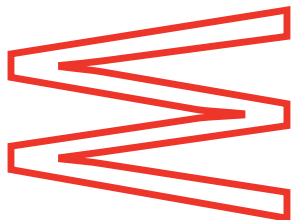
1. What are common problems or issues consumers face at closing? What parts of the closing process do consumers find confusing or overwhelming?
2. Are there specific parts of the closing process that borrowers find particularly helpful?
3. What do consumers remember about closing as related to the overall mortgage/home- buying process?
4. How long does the closing process usually take and do borrowers feel this time is of appropriate length?
5. How empowered do consumers seem to feel at closing? Did they come to closing with questions? Did they review the forms beforehand? Did they know that they can request their documents in advance? Did they negotiate?
6. What, if anything, have you found helps consumers understand the terms of the loan?
7. What are some common errors you have seen at closing? After closing? How are these errors detected, if at all?
8. What changes often surprise consumers at closing? How do consumers react to changes at closing?
9. How, if at all, do consumers typically seek advice during closing? In person? By phone? Online?
10. Where and to whom do consumers turn for advice during closing? Whom do they typically trust?
11. What documents do borrowers usually remember seeing? Signing?
12. What documents do consumers find particularly confusing?
13. What resources do borrowers use to define unfamiliar terms of the loan?
14. What, if anything, would you change about the closing process to make it a better experience for consumers?
15. What questions should consumers ask at closing? What are the most important pieces of information/documents for them to review?
16. What is the single most important thing a consumer should do before coming to the closing table?





CFPB Mortgage Servicing and Origination Examining Procedures

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The beginning of 2014 marked the implementation of new rules for mortgage servicers, lenders and brokers. According to CFPB Director Richard Cordray in his [testimony](#) before the House Financial Services Committee, the goal and purpose of the organization is to take a “back to basics” approach to mortgage lending practices. This is quite evident in the Mortgage Servicing and Origination Examination Procedures recently implemented by the CFPB. For the complete Mortgage Servicing and Origination Examination Procedures, you can visit the CFPB [website](#).

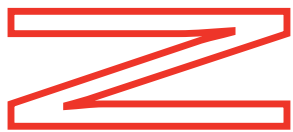


The objectives of the mortgage servicing examination procedures are to: (1) assess the quality of the regulated entity’s compliance risk management systems; (2) identify acts that materially increase the risk of violations of federal mortgage servicing laws; (3) gather facts that help determine whether a regulated entity engages in acts or practices that are likely to violate federal mortgage servicing laws; and (4) determine whether a violation of a federal consumer financial law has occurred and whether further supervisory or enforcement actions are appropriate.

To carry out these objectives, the examination process will include assessing risks that are not governed by federal laws, which the CFPB terms “UDAAPs” – unfair, deceptive or abusive acts or practices. A representation, omission, act or practice is deceptive when: (1) it misleads or is likely to mislead the consumer; (2) the consumer’s interpretation of the representation, omission, act or practice is reasonable under the circumstance; and (3) the misleading representation, omission, act or practice is material. An act or practice is unfair when: (1) it causes or is likely to cause substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers; and (3) the injury is not outweighed by countervailing benefits to consumers or to competition. An abusive act or practice is defined as one that: (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service, or (2) takes unreasonable advantage of the consumer’s lack of understanding of the material risks, costs or conditions of the product or service; the consumer’s inability to protect its interest in selecting or using a consumer financial product or service; or the consumer’s reasonable reliance on a covered person to act in the interests of the consumer.

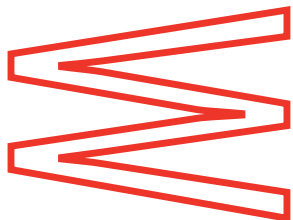
The Mortgage Servicing Examinations evaluate servicing transfers, payment processing, consumer inquiries, maintenance of escrow accounts and insurance products, credit reporting, information sharing, collections and bankruptcy accounts practices, loss mitigation, foreclosures and conclusions.

Under the servicing transfer module, examiners have to assess potential federal law violations by reviewing sample servicing records, including the current servicer’s records, prior servicer records and records outside of the servicer records. In order to review payment processing, examiners can review servicer records, including monthly payment statements. Most notably, examiners can interview consumers to ensure compliance. To review consumer inquiries, examiners can listen to live and taped calls to assess the quality and training of call center personnel and determine whether complaints were resolved adequately. As far as maintenance of escrow accounts, examiners are to review servicer records to ensure compliance with federal laws and can even conduct interviews with consumers and staff.



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**CFPB Mortgage Servicing and Origination Examining Procedures, *continued***

To ensure proper credit reporting, examiners are to compare the information in the servicer's system with the information reported to credit reporting agencies to confirm accuracy. Additionally, examiners must verify that servicers are complying with consumer information sharing and privacy rules.

To assess collections and bankruptcy accounts, examiners are to confirm that servicers are complying with bankruptcy laws. Of note, examiners will evaluate whether servicers notified the debtor of the total amount due, including principal, interest and fees, as of the date of the bankruptcy filing. The loss mitigation module focuses on whether there is evidence of disparate treatment. Under the foreclosure module, examiners are to ensure that the borrower is, in fact, in default and that the amounts in the foreclosure affidavits match the amounts recorded in the servicer's records.



The Mortgage Origination Examination Procedures apply to mortgage brokers and mortgage lenders. The examination objectives mirror those of the mortgage servicing examination procedures. The purpose of the examination rules is for examiners to develop a thorough understanding of mortgage brokers' and lenders' practices and operations. To achieve this, examiners should obtain and review each entity's: organizational charts and process flowcharts, loan applications, wholesale and correspondent lending agreements, training programs and materials, service provider contracts and complaints, among other things.

Origination examinations cover the company business model, advertising and marketing, loan disclosures and terms, underwriting, closing, fair lending privacy and examiner conclusions. Examiners are to comprehensively evaluate an entity's business model including the type of mortgage origination channel used by the entity, funding sources and training programs. Examiners are to develop a detailed understanding of the entity's marketing program to determine whether its marketing, policies, procedures and practices are consistent with the applicable laws and regulations. As far as loan disclosures and terms, examiners should identify acts, practices and materials that indicate potential violations of federal laws. Examiners are to review underwriting procedures for mortgage lenders, appraisal policies and procedures, and compensation policies for loan originators. Examiners are to review the way lenders conduct closings to ensure that they are complying with disclosure requirements. The purpose of a fair lending examination is to determine whether the creditor discriminated on a prohibited basis in any aspect of its credit operations. Examiners must ensure consumers' nonpublic information is protected as required by federal law.

Both examination procedures conclude with the examiner summarizing their findings, determining the root cause of the violations noted, identifying the actions needed to correct violation, discussing the findings with the entity's management, recording the violations in the CFPB database, contacting the appropriate agency if enforcement action is appropriate and preparing a memorandum for the CFPB's database.

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