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Consumer Financial Protection Bureau Alert—Vol. 2, No. 8

By the Authors of PLI's Consumer Financial Services Answer Book 2011 and Edited by Arthur B. Axelson
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News and Views: Consumer Financial Protection Bureau

Regulations and Guidance Update

CFPB Steps Up Enforcement of Anti-Discrimination Laws

In keeping with its twin goals of protecting consumers and empowering them to be able to protect themselves, the Consumer Financial Protection Bureau (CFPB) put financial institutions on notice that it is stepping up enforcement of anti-discrimination laws. CFPB Director Richard Cordray explained that in a recovering economy, "[w]e cannot afford to tolerate practices that either price out or cut off segments of the population." All financial institutions under CFPB supervision—banks and nonbanks alike—will be monitored for potential fair lending violations including practices with unlawful discriminatory effects.

The CFPB said it will use "all available legal avenues, including disparate impact, to pursue lenders whose practices discriminate against consumers." To that end, the Bureau issued CFPB Bulletin 2012-04 reaffirming its commitment to the Equal Credit Opportunity Act (ECOA), which it enforces jointly with the Justice Department. The Bureau emphasized the problem of disparate impact, which occurs when a lender's practices or policies are facially neutral but have discriminatory effects; the Bureau has made it clear it will pursue actions against lenders even when discrimination is unintentional. One example of this kind of policy that can cause discriminatory effects is giving loan officers broad discretion to determine how much to charge borrowers. However, the CFPB said it would afford institutions some flexibility. Practices that have a discriminatory effect but meet a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact will be permissible.

Industry observers are not surprised by the CFPB's latest move and had long expected the Bureau to join the Justice Department in aggressively pursuing fair lending cases. The CFPB itself had already said it planned to examine disparate impact claims under the ECOA in its supervision exam manual released last year. Disparate impact was the basis for a major settlement in a case brought by the Justice Department against Bank of America. In December 2011, Bank of America was forced to pay more than $335 million to settle claims of discriminatory lending against Latino and black borrowers at its Countrywide mortgage lending unit.

Unlike other regulatory agencies, the CFPB has independent litigating authority, meaning it can bring its own cases against lenders in federal court. It can also hold adjudication proceedings before the Bureau's own administrative judges, who can issue cease and desist orders and penalties , and provide equitable relief for borrowers. However, the CFPB must still refer fair lending violations to the Justice Department when there is evidence of a pattern or practice of discrimination.

But the CFPB is also aware of the limits of its reach. To that end, the Bureau is educating consumers about their fair lending rights and equipping them with the information they need to spot the warning signs of discrimination on their own.

CFPB Rejects Transitional License for Former Bank LOs, Allows State Reciprocity

With the issuance of Bulletin 2012-05, on April 19, 2012, the CFPB laid to rest the question of whether loan originators working for depository institutions will be able to seamlessly transition to employment with a nonbank mortgage lender or broker through the use of a transitional license structure, and the answer was not the one many nonbanks had hoped for. In response to inquiries from state regulators as to whether the states may allow registered loan originators to originate loans on behalf of non-depository institutions while the individuals pursued licensure under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act), the CFPB opined that such transitional licensing is not permitted under Regulation H, the SAFE Act regulation.

Pursuant to the SAFE Act, loan originators who work for depository institutions or certain other federally regulated institutions are required to register as a loan originator and obtain a unique identifier through the Nationwide Mortgage Licensing System and Registry (NMLSR). Such individuals are not required to meet the same testing, education or background check requirements as individuals who work for nonbank mortgage lenders and brokers must meet in order to obtain SAFE Act licenses. Because the licensing process, including meeting the prerequisites, can take several weeks, individuals who originate loans for banks and who do not hold loan originator licenses are not able to change employment to work for a non-depository institution without an interruption in their ability to originate loans. The CFPB indicated that Regulation H does not permit states to provide for a transitional license for a registered loan originator who is pursuing a loan originator license while working for a non-depository institution. However, the CFPB stated that it "recognizes that this can create impediments to job changes" and confirmed its commitment to "working with the states, industry, and the NMLSR to minimize these impediments going forward, consistent with the statutory language of the SAFE Act.

The CFPB did not completely reject the concept of transitional licensing, however. In response to state inquiries regarding the ability of one state to rely on an individual's license in another state in considering an application for transitional licensing, the CFPB advised that such an approach was within a state's rights under the SAFE Act and Regulation H. Because the preamble to the SAFE Act rule stated that the rule "[did] not limit the extent to which a state may take into consideration or rely upon the findings made by another state in determining whether an individual is eligible under its own laws," the CFPB concluded that a state could elect to provide a transitional loan originator license to an individual who holds a valid loan originator license from another state. The individual would be required to meet either the net worth or surety bond requirement, or pay into a state fund, as required by the loan originator supervisory authority in the second state.

CFPB Intends to Review Banks' Overdraft Practices

The CFPB is reviewing bank overdraft practices and will decide by the close of the year whether to create new rules on these practices. Bank regulators have been investigating bank overdraft policies over the past several years when it was determined that banks collectively made billions of dollars in overdraft fees by rearranging consumers' transactions to process the largest transactions first. The reordering of payment processing based on the type or amount of debit transactions can have a major effect on the number of overdrafts a consumer may experience.

Currently, the CFPB is questioning the efficacy of the prior restraints on banking institutions' overdraft practices given the very slight difference in revenue banks have earned since 2011. For example, in 2010, overdraft fees earned banks $33.1 billion. Last year, the number was slightly down to $31.6 billion. The CFPB is reviewing banks' justifications for the size of overdraft fees. Large banks on average charge $35 in overdraft fees while community banks and credit unions only charge $25 on average. While stricter rules are likely to benefit consumers, it is predicted that banks will suffer. For example, in 2011, Wells Fargo made $4.3 billion dollars from fees including overdrafts. This sum equals almost a fourth of the bank's net income. And, JP Morgan raked in $3.2 billion in fees related to lending and deposits.

While the size of overdraft fees are likely to be addressed by the CFPB, the CFPB will largely focus on how financial institutions explain their overdraft protection practices to their consumers and how they market such products. CFPB Director Richard Cordray previously stated that the agency targets banks that "exploit consumers with deceptive marketing." The Bureau is also coordinating with the federal banking agencies in the hope of providing a common guidance on the matter.

The CFPB requested public comment about the impacts of overdraft programs on consumers in February and recently extended the comment period from April 30, 2012 to June 29, 2012. Comments regarding the costs, benefits and risk to consumers of overdraft programs may be submitted to http://www.regulations.gov.

Bureau Requests Guidance on Structure of Arbitration Study

On April 25, 2012, the CFPB published a notice and request for comment regarding the structure of its study of arbitration clauses. Section 1028(b) of the Dodd-Frank Act, requires the CFPB to conduct a study concerning the use and effect of arbitration clauses in connection to consumer financial service products. After finalizing the study, the CFPB must report its findings to Congress. Comments must be received by the Bureau by June 23, 2012.

The CFPB has set clear parameters for the information it now seeks. The CFPB has emphasized that it is *not* looking for suggestions or comments as to how the CFPB should exercise its rulemaking authority; whether pre-dispute arbitration clauses should be limited or prohibited; or, whether regulations are in the public interest. Rather, the CFPB is only interested in obtaining information that would help identify the *appropriate methods, scope, and data that should be employed for the arbitration study*. To help limit an influx of superfluous comments, the CFPB has identified three topics in which it seeks information: (1) the prevalence of use of arbitration; (2) the use and impact of arbitration in particular arbitral proceedings; and, (3) the impact and use of arbitration outside particular arbitral proceedings. In short, the purpose of the CFPB's request for comment is to sculpt the arbitration study required under section 1028(b), not to determine whether arbitration clauses in consumer financial services products are proper.

The CFPB is remaining tight-lipped about whether its anticipates the arbitration study will result in new regulations limiting or even prohibiting arbitration completely. However, the general consensus in the legal field is that increased regulations are almost a certainty given the CFPB's intent to not just accept the status quo, but to delve into areas of possible consumer harm and rectify any potential for consumer abuse. It is unlikely that arbitration clauses will be prohibited entirely, but if the CFPB strictly regulates the use of arbitration in connection with consumer financial service products, the benefits to lenders of such proceedings may dissipate.

Although the Supreme Court in *AT&T Mobility LLC v. Concepcion,* 131 S.Ct. 1740 (2011), recently upheld the validity of arbitration clauses, this protection may be short-lived. The Dodd-Frank Act grants the CFPB specific authority to prohibit or impose conditions on the use of arbitration clauses and essentially supersedes the Supreme Court holding. Thus, if the CFPB determines that arbitration clauses should be prohibited in connection with consumer financial service products (or severely restricted) after it completes the arbitration study, the CFPB has the authority to impose regulations that do so.

Examinations/Enforcement Here and Now

Bureau Comments on Supervision and Enforcement

Steve Antonakes, head of the Depository Supervision Unit of the CFPB recently spoke at a Financial Services Roundtable event in Washington, D.C. on various supervision and enforcement issues. We attended the event and have provided a list of some of his key points below:

- Bureau has engaged a number of banks. Different approach for different sized banks. One size does not fit all. Not reviewing community banks, so rumors are false. Doubtful will exercise this authority any time soon.
- Not all violations must lead to formal enforcement action. Should be a proportional response, so can avoid some public disclosures. Examination will include enforcement as part of "entry meeting" and will not be on site. Supervision will integrate with enforcement.
- Currently 60 percent staffed on supervision side. Want career bank examiners. Also have some nonbank personnel picked up from States. Does actually believe that CFPB should include those who actually have underwritten loans and not just criticized them.
- Largest banks ($100 billion plus) will have continuous supervision, on regular basis. Product reviews, by quarter. Quarterly write ups with core team, supplemented by personnel with expertise in particular markets. For smaller banks, examination will include 4-10 examiners. If clean exam, will not return for 2-3 years.
- Mortgage servicing, credit cards and payday lending will be focus of his efforts.
- Fair lending issues will be handled separately, but CFPB divisions will work together. Expect reviews regarding automobile lending. HMDA data of nonbank mortgage companies will be a focus. Their data has been quite bad.
- Bureau will be very careful regarding UDAAP. No field authority to determine something is an abusive practice. Credit card lending and mortgage servicing will be the focus here.
- Level playing field issue: Bureau is moving more deeply into nonbank space. Nonbank supervision is not the same. Nonbanks have lied to the Bureau and there will be more scheduled exams. Checking dumpsters for documents.
- CFPB should not be asking for anything that the prudential regulators have not asked for.

- While the Bureau is not a safety and soundness regulator, it understands the need to have a profitable banking industry.
- In regard to information sharing with state Attorneys General, the Bureau will not share examination information. However, if a state AG has a basis for needing the information, the Bureau will share it.
- Consumer complaint processing will be ramping up. It serves as an early warning system for the Bureau. May trigger need for an earlier examination of a particular institution. The Bureau is also using the complaint process as a surveillance tool.

News from the Bureau

Massive Student Debt Affects the Economy and Other Types of Lending

A recent CFPB report disclosed that outstanding student loan debt now totals over $1 trillion, and the debt burden is causing problems for many first-time home buyers. According to mortgage industry experts, many first-time buyers are turned down for mortgages because their student loan debt significantly raises their overall debt level. This is particularly true given that some student loan payments are as high as a mortgage. Mark Kantrowitz, the founder of FinAid.org, recommends that borrowers restructure or consolidate student loans at a reduced interest rate to lower monthly payments.

Why is the student debt crisis such a hot issue, with President Obama and Mitt Romney supporting efforts to extend loan subsidies that expire in July? The answer is the debt burden negatively impacts the economy because young people are strapped and unable to buy homes or start businesses.Additionally, like risky mortgages, risky private student loans have been packaged into securities that are sold to the public. Concerns are growing that a pileup of student-loan defaults could jeopardize these investments, resulting in a burst similar to the housing bubble breakdown.

Industry Groups Continue to Discuss Anticipated QM Rule

Interest groups continue to weigh in on the anticipated “qualified mortgage” (QM) rule, which the CFPB expects to propose by the end of June. The CFPB must finalize the QM rule by January 13, 2013 under the Dodd-Frank Act, but hopes to issue a final rule in the third quarter of 2012. Because of the potential liabilities for lending outside of the QM rule in regard to a borrower’s ability to repay, lenders and industry insiders anticipate that once QMs are defined, mortgage lenders will only offer borrowers loans that meet the QM guidelines. Because the QM rule will shape the future of the mortgage industry, advocates and industry insiders have raised a number of issues they hope the CFPB will consider in finalizing the rule.

Comments from the Bureau have indicated that it is well aware of the implications of the rule. Nonetheless, the CFPB wants a qualified mortgage to be structurally safer than mortgages in the past and to pose lower risks to borrowers. Raj Date, the deputy director of the Bureau, has stated that “first and foremost, [the Bureau] want[s] to ensure that consumers are not sold mortgages they do not understand and cannot afford.” At the same time, Mr. Date indicated that the Bureau “want[s] to minimize the compliance burden where possible, in part through the careful definition of those lower-risk qualified mortgages.”

A number of mortgage lender advocates have raised concerns that ambiguity in the QM rule and “ability to repay” underwriting standards will result in significant litigation costs. In particular, housing industry groups have encouraged the CFPB to adopt a safe harbor from liability for mortgagors that comply with the QM rule instead of a rebuttable presumption of compliance. A rebuttable presumption would create a much lower bar for attorneys to challenge a lender’s compliance with the “ability to repay” standard, which could incentivize meritless lawsuits that lenders would have to defend or settle and that could delay or stop foreclosures. Should the CFPB adopt a rebuttable presumption, industry groups fear that litigation costs will prevent most lenders from offering mortgages to all qualified borrowers. Another issue of concern is the definition of points and fees since such charges on a QM of greater than $75,000 may not exceed 3 percent. If the definition of these charges is not precise, lenders may run afoul of the QM exemption.

Consumers groups and mortgage lender advocates alike have raised concerns regarding the breadth of the QM rule. Because it is largely anticipated that lenders will not extend credit beyond the QM guidelines, consumer and industry advocates have both indicated that too many limits on the kind of mortgage that can be offered or the fees that can be associated with the QM loan could create disincentives for mortgage lenders and banks to lend. U.S. Housing and Urban Development (HUD) Secretary Shaun Donovan urged the CFPB to look at the types of loans that created the housing crisis rather than focus on the number of loans that might be eligible under the QM rule. Raj Date has indicated that access to credit is a priority for the CFPB. He noted that a narrow definition of a QM could result in fewer loans made to minority borrowers or in non-traditional markets, such as self-employed borrowers, a result the Bureau hopes to avoid.

The six regulators charged with defining a "qualified residential mortgage" (QRM) for purposes of the Dodd-Frank risk retention rule (HUD, SEC, OCC, FRB, FDIC, FHFA) have indicated that they are awaiting the Bureau's definition of a QM before they tackle the QRM definition. The QRM rule will establish the guidelines for an exemption from a 5 percent risk retention requirement for certain securitized loans. HUD Secretary Donovan, in speaking at a Mortgage Bankers Association conference, indicated that he favors a single underwriting standard for QM and QRM as much as possible.

CFPB Office of Minority and Women Inclusion Gets Director

The Bureau recently announced the hiring of Stuart J. Ishimaru as director of the Dodd-Frank-mandated CFPB Office of Minority and Women Inclusion (OMWI). Ishimaru previously served as head of the Equal Employment Opportunity Commission. The new OMWI was created both to increase diversity within the Bureau itself and to encourage diversity at the firms the Bureau regulates. The Bureau is required to assess the diversity policies and practices of the entities it regulates and Mr. Ishimaru believes "[o]btaining diversity data from regulated entities will facilitate appropriate changes to the financial services industry." He and CFPB head Richard Cordray recognize that the Bureau does not have authority to force employers to change their hiring processes since the Office of Minority and Women Inclusion, like its counterparts in other regulatory agencies, does not have rulemaking authority. Nonetheless, the OMWI will be promoting diversity in hiring. According to Ishimaru, his office will not be "forcing people to [diversify hiring], but it lets them know how to do it." Cordray added that the Bureau wishes to collect data from those in the financial services industry "without imposing an undue regulatory burden." Cordray sees the new office as "a tremendous opportunity for the bureau to encourage diversity." Ishimaru also believes his office can "serve as a model" for achieving diversity in the workplace.

Regulatory Scorecard

Please click here to access a printable version of the Dykema Regulatory Scorecard, our up-to-date chart of pending and final regulatory activities and proceedings at the CFPB.

Contacts and Caveats

For more information about Dykema's Financial Services Regulatory and Compliance practice, please contact group leader, **Don Lampe** at 704-335-2736, **Arthur B. Axelson** at 202-906-8607, or any of the listed attorneys.

Attorneys

Joseph H. Hickey

Theodore W. Seitz

Practice Areas

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