The Law Offices of
FERNS, ADAMS & ASSOCIATES
A Professional Corporation

Northern California Office
2815 Mitchell Drive, , Suite 210
Walnut Creek, CA. 94598
telephone (925) 927-3401
facsimile (925) 927-3419

Southern California Office
150 S. Los Robles Ave, Suite 455
Pasadena, CA. 91101
telephone (626) 584-7410
facsimile (626) 584-7409

The Consumer Financial Protection Bureau

by Barry and Amanda Ferns

The purpose of these materials are to give a general overview of the Consumer Financial Protection Bureau ("CFPB") and its affect on Credit Unions as it relates to real estate lending and servicing requirements on new loans.

The Consumer Financial Protection Bureau (CFPB) is an independent agency of the United States government responsible for consumer protection in the financial sector. Its jurisdiction includes banks, credit unions, securities firms, payday lenders, mortgage-servicing operations, foreclosure relief services, debt collectors and other financial companies operating in the United States.

A. CFPB'S Formation:

In July 2010, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act, during the 111th United States Congress in response to the financial crisis of 2007–08 and the subsequent Great Recession. The agency was originally proposed in 2007 by Harvard Law School professor **Elizabeth Warren** (now Senator Elizabeth Warren from Massachusetts). The proposed Consumer Financial

Protection Bureau was actively supported by Americans for Financial Reform, a newly created umbrella organization of some 250 consumer, labor, civil rights and other activist organizations.

The purpose of the CFPB is to be an independent federal agency who's primary responsibility is to regulate consumer protection with regard to financial products and services in the United States, such as Mortgages, Loans and Credit Cards. According to the CFPB's web site "Our mission is to make markets for consumer financial products and services work for Americans — whether they are applying for a mortgage, choosing among credit cards, or using any number of other consumer financial products."

On September 26, 2013, the Consumer Financial Protection Safety and Soundness Improvement Act of 2013 (H.R. 3193; 113th Congress) was introduced into the United States House of Representatives. If passed, the bill would modify the CFPB by transforming it into a five person commission and removing it from the Federal Reserve System. The CFPB would be renamed the "Financial Product Safety Commission." This bill was also intended to make it easier to override the decisions that the CFPB makes by authorizing the Chairperson of the Financial Stability Oversight Council to issue a stay of, or set aside, any regulation issued by the Consumer Financial Protection Bureau (CFPB) upon the affirmative vote of the majority of Council members (currently, two-thirds), excluding the Director of the Bureau. It also requires that the CFPB Director, when prescribing a rule under federal consumer financial laws, to consider its impact upon the financial safety or soundness of an insured depository institution. The bill passed the House of Representatives on February 27, 2014 and according to House Majority Leader Eric Cantor, has been sent to the Senate for consideration.

B. CFPB'S Director:

On September 17, Obama announced the appointment of Elizabeth Warren as Special Advisor to set up the bureau. The bureau began operation on July 21, 2011, shortly after Obama announced that Ms. Warren would be passed over as Director in favor of **Richard Cordray**, who prior to the nomination had been hired as chief of enforcement for the agency. As Ohio Attorney General from 2009 to 2011, Mr. Cordray won $2 billion in settlements from financial companies.

In essence, the CFPB did not have a Director until fairly recently. That meant that before Richard Cordray was appointed, the CFPB could not make any rules or exercise its enforcement powers under Dodd-Frank. Now that they have this power, the CFPB will have oversight of non bank firms (like Credit Unions) who will have to submit reports to the CFPB but be subjected to new lending requirements and regulations.

C. Mission and Vision:

As stated in the CFPB's own web site,

Their **"Mission"** is:

"The CFPB is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives."

Their **“Vision”** is:

> “If we achieve our mission, then we will have encouraged the development of a consumer finance marketplace where customers can see prices and risks up front and where they can easily make product comparisons; in which no one can build a business model around unfair, deceptive, or abusive practices; that works for American consumers, responsible providers, and the economy as a whole.”

It should be noted that the federal government had here-to-fore been somewhat reluctant to adopt such far reaching rules and regulations to protect consumer abuse situation, allowing a piece meal approach such as enacting the Truth in Lending Act of 1968 (15 U.S.C. 1601 et seq.), Fair Housing Act of 1968 (42 U.S.C. §3601, et seq), the Equal Credit Opportunity Act of 1974 (15 U.S.C. §1691, et seq.), Federal Fair Debt Collection Practices Act of 1977 (15 U.S.C. §1692, et sec), and the Americans with Disabilities Act of 1990 (42 U.S.C. §12111, et seq).

C. CFPB Reach:

In it’s quest to protect consumers, the CFPB will work to carry out various federal consumer laws and regulations. According to their web site, the CFPB will:

- ✳ Conduct rule making, supervision and enforcement with respect to the Federal consumer financial laws;
- ✳ Handle consumer complaints and inquiries;
- ✳ Promote financial education;
- ✳ Research consumer behavior; and
- ✳ Monitor financial markets for risks to consumers.

The CFPB will also attempt to restrict any allegedly unfair, deceptive, or abusive acts or practices.

If you were wondering who the CFPB could reach, their jurisdiction includes banks, credit unions, securities firms, payday lenders, title loan lenders, mortgage-servicing operations, foreclosure relief services, debt collectors, credit card companies, student loan's and other financial institutions. **They intend to send their tentacles into every type of financial institution in order to carry out their "mission".**

D. The Scope of the CFPB's Examination Process:

The CFPB has already identified 111 depository institutions subject to the supervision and examination program, although it has not released a list of these institutions. Under the Dodd-Frank Act, this list will include an insured depository institution with total assets of more than $10 billion. But the CFPB also has authority under Dodd-Frank to supervise covered institutions' affiliates and service providers. Dodd-Frank defines "affiliates" to include any person that controls, is controlled by, or is under common control with another person. "Service providers" are defined as companies providing a material service to a covered institution. "Material services" include designing, operating, or maintaining a consumer financial product or service and processing related transactions. Because the CFPB is prepared to seek corrective action for any violations, through additional policies and procedures or other remedies, affiliates of and service providers to covered institutions should be prepared to comply with the CFPB's examination process.

It may be good to know that the CFPB is only going to monitor smaller depository institutions on a periodic basis (which is what the Dodd-Frank Act provides for) but will monitor the largest and most complex banks on a year long basis. These “too big” to fail institutions have basically brought this regulatory burden down on everyone because of their actions over the last few decades. However, unless a Credit Union has assets in excess of $10 billion dollars, these examinations should not be an everyday occurrence for them.

Currently, the CFPB will only directly examine the more than 100 “large’ banks, thrifts and credit unions, as well as their affiliates, that are subject to CFPB supervision. The federally insured depository institutions are defined as large when they have total assets over $10 billion. As you can well imagine, those institutions account for the majority of lending in this country. Billion dollar “to big to fail” financial institutions may be continually audited all year round while much smaller institutions may be audited only once a year. That does not mean that the CFPB may not have “indirect” oversight or examination authority in that they can respond to consumer complaints. **If the CFPB receives such a request, it can ask the financial institution to respond to it.**

E. CFPB AMENDMENTS TO REGULATION Z:

What the CFPB did was to amend Regulation Z (200 + pages long) which has been around since 1968. Regulation Z is issued by the Board of Governors of the Federal Reserve System to implement the Federal Truth in Lending Act, which is contained in title I of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 et seq.).

What is interesting is that Regulation Z already prohibits a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to repay the loan. Under 12 CFR §226.35, "a **higher-priced mortgage loan** is a:

- ✳ consumer credit transaction secured by the consumer's principal dwelling;
- ✳ with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for loans secured by a first lien on a dwelling, or by 3.5 or more percentage points for loans secured by a subordinate lien on a dwelling."

Higher-priced mortgage loans are subject to the following restrictions:

(1) Repayment ability. A creditor shall not extend credit based on the value of the consumer's collateral without regard to the consumer's repayment ability as of consummation as provided in § 226.34(a)(4).

(2) Prepayment penalties. A loan may not include a penalty described by § 226.32(d)(6) unless:

(i) The penalty is otherwise permitted by law, including § 226.32(d)(7) if the loan is a mortgage transaction described in § 226.32(a); and

(ii) Under the terms of the loan—

(A) The penalty will not apply after the two-year period following consummation;

(B) The penalty will not apply if the source of the prepayment funds is a refinancing by the creditor or an affiliate of the creditor; and

(C) The amount of the periodic payment of principal or interest or both may not change during the four-year period following consummation.

(3) Escrows—

(I) Failure to escrow for property taxes and insurance. Except as provided in paragraph (b)(3)(ii) of this section, a creditor may not extend a loan secured by a **first** lien on a principal dwelling unless an escrow account is established before consummation for payment of property taxes and premiums for mortgage-related insurance required by the creditor, such as insurance against loss of or damage to property, or against liability arising out of the ownership or use of the property, or insurance protecting the creditor against the consumer's default or other credit loss.

(ii) Exemptions for loans secured by shares in a cooperative and for certain condominium units— ....

(iii) Cancellation. A creditor or servicer may permit a consumer to cancel the escrow account required in paragraph (b)(3)(I) of this section only in response to a consumer's dated written request to cancel the escrow account that is received no earlier than 365 days after consummation.

(iv) Definition of escrow account. For purposes of this section, "escrow account" shall have the same meaning as in 24 CFR 3500.17(b) as amended.

(v) "Jumbo" loans. For purposes of this § 226.35(b)(3), for a transaction with a principal obligation at consummation that exceeds the limit in effect as of the date the transaction's interest rate is set for the maximum principal obligation eligible for purchase by Freddie Mac, the coverage threshold set forth in paragraph (a)(1) of this section for loans secured by a first lien on a dwelling shall be 2.5 or more percentage points greater than the applicable average prime offer rate.

(4) Evasion; open-end credit. In connection with credit secured by a consumer's principal dwelling that does not meet the definition of open-end credit in § 226.2(a)(20), a creditor shall not structure a home-secured loan as an open-end plan to evade the requirements of this section.

Starting January 10, 2014, under the CFPB Amendments, any federally insured institution (ie: Federally insured Credit Union") **must assess the borrower's ability to repay** for virtually all closed-end residential mortgage loans, comply with the CFPB's new rules and maintain records of such compliance.

F. THE ABILITY TO REPAY ("ATR") RULE:

The final rule implements sections 1411 and 1412 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which generally require creditors to make a **reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling** (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan) and establishes certain protections from liability under this requirement for "**qualified mortgages**." This "final rule" also implements section 1414 of the Dodd-Frank Act, which limits prepayment penalties and requires creditors to retain evidence of compliance with the rule for **three years** after a covered loan is consummated.

Why do they have a rule which requires a financial institution to determine whether or not a consumer has the ability to repay a consumer credit transaction secured by a dwelling?

According to the people behind the making of this rule, they found that:

> "during the years preceding the mortgage crisis, too many mortgages were made to consumers without regard to the consumer's ability to repay the loans. Loose underwriting practices by some creditors—including failure to verify the consumer's income or debts and qualifying consumers for mortgages based on "teaser" interest rates that would cause monthly payments to jump to unaffordable levels after the first few

years—contributed to a mortgage crisis that led to the nation's most serious recession since the Great Depression"

It seems clear that some financial institutions were not actually assessing the ability of a borrower to repay his or her mortage loan. What resulted was that too many borrowers ended up with risky loans which they could not afford. Those borrowers oftentimes allowed their homes, once it became clear that they could not afford the mortgage payments, to go into foreclosure. With so many foreclosures, the values of most everyone's homes went down.

Ability-to-Repay Determinations. The final rule describes certain minimum requirements for creditors making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. At a minimum, creditors generally must consider eight underwriting factors:

(1) current or reasonably expected income or assets;

(2) current employment status;

(3) the monthly payment on the covered transaction;

(4) the monthly payment on any simultaneous loan;

(5) the monthly payment for mortgage-related obligations;

(6) current debt obligations, alimony, and child support;

(7) the monthly debt-to-income ratio or residual income; and

(8) credit history. Creditors must generally use reasonably reliable third-party records to verify the information they use to evaluate the factors.

The CFPB rules do not preclude a lender from considering other credit factors in approving a consumer mortgage loan. However, that lender does have to consider the eight (8) factors set forth above. It would be a good idea to create a check list for the credit department to use in order to prove that it considered all eight factors as required. Remember, lawsuits do happen (for good or bad) and, as Tom Cruise said in "A Few Good Men": "its what you can prove in court......" You would also want this check list for any auditor to review should there be an audit.

Under the CFPB rules, the retention of evidence of complaint with the ATR rule is mandatory. The evidence must be retained for a minimum of **three (3)** years after the loan is consummated. You do not have to retain the actual paper copies of the documents used in underwriting the loan but you have to be able to reproduce such records accurately. In addition, CFR Part 12 §1026 also requires the retention of certain disclosure documents for **five (5)** years after a loan is sold AND allows for an audit.

It seems clear that Congress is stepping in to ensure that financial institutions, particularly mortgage lenders, make a reasonable AND good faith effort to ensure that a borrower can afford the loan before allowing it to be made. The market place should have demanded this but as we have experienced, it just did not happen and everything fell apart. So, a lender needs to collect the above data and document it and just not rely on such tricks as a low introductory or "teaser" rate to figure out whether or not a borrower has the ability to repay a loan. As a "safe harbor" rule, a lender can comply with the ATR rule by making a "**Qualified Mortgage**" to a borrower.

All **Qualified Mortgages** (QM) are presumed to comply with the ATR rule. The following are Mandatory product feature which are required for all QMs:

1. Points and fees are less than or equal to 3% of the loan amount (for loan amounts less than $100k, higher percentage thresholds are allowed and remember, not all charges, like the cost of a credit report, are included in this limit);

2. No risky features like negative amortization, interest-only, or balloon loans (BUT NOTE: balloon loans originated until January 10, 2016 that meet the other product features are QMs if originated and held in portfolio by small creditors);

3. Maximum loan term is less than or equal to 30 years.

As described below, a loan that meets the product feature requirements of a Mortgage loan can be a QM under any of three main categories:

1. General definition category of QMs

   Any loan that meets the product feature requirements with a debt-to-income ratio of 43% or less is a QM. The borrowers mortgage and other monthly debt payments are included in the "debt" part of this scenario.

2. "GSE-eligible" category of QMs

   Any loan that meets the product feature requirements and is eligible for purchase, guarantee, or insurance by a Government Sponsored Enterprise (FSE) such as Fannie Mae and Freddie Mac. Besides Fannie and Freddie, another popular GSE is Ginnie Mae, Federal Housing Authority (FHA), Veterans Administration (VA), or United States Department of Agriculture (USDA) **is QM regardless of the debt-to-income ratio** (this QM category applies for GSE loans as long as the GSEs are in FHFA conservatorship and for federal agency loans until an agency issues its own QM rules, or January 10, 2021, whichever occurs first).

3. Small creditor category of QMs

> If you have less than $2B in assets and originate 500 or fewer first mortgages per year, loans you make and hold in portfolio are QMs as long as you have considered and verified a borrower's debt-to-income ratio (though no specific Debt to Income limit applies).

Hopefully, most credit unions will qualify as a "Small Creditor." Still, a credit union should follow these **GENERAL RULES**:

1. Follow the above QM rules;
2. Do not put on the books any of the following loans:
    a. Negative Amortization;
    b. Interest only payments;
    c. Terms that exceed thirty (30) years;
    d. No limits on points and fees;
    e. No balloon payments
    f. That are subjected to a forward commitment.
3. Underwrite the loan based on a fully amortizing schedule using the maximum rate permitted during the first five yeas after the date of the first periodic payment;
4. Verify, and document, the members income, assets, debts, alimony, child support and child care costs;
5. Definitely consider, and document, the members debt to income ratio or residual income (even thought the 43% rule does not apply to small creditors);

6. Do not sell or transfer the loan within three (3) years of consummation or if you do, sell to another small creditor who meets the above criteria or sold pursuant to a supervisory action or agreement or as part of a merger or acquisition of or by another creditor.

The financial institution must keep the mortgages on its books however. The rule also includes a two-year transition period that give a small lenders the ability to make certain balloon loans that will count as QMs.

> EXTRA NOTE: Even if a loan is not a qualified mortgage, it can still be an appropriate loan. You can originate any mortgage (whether or not it is a QM) as long as you make a **reasonable, good-faith determination that the consumer is able to repay the loan based on common underwriting factors**. You can continue to rely on your sound, tested underwriting guidelines that you have used in the past to make loans that have generally performed well, as long as you document the information you consider.

A lender can have certain legal protections if it can show that it made sure that a borrower had the ability to repay his or her loan. However, that would not stop that same borrower from filing suit, claiming that at the time of the loan that the lender "knew" that he or she did not have the ability to repay the loan.

G. CFPB SERVICING RULES:

1. The CFPB's servicing rule prohibits servicers from making the "first notice or filing" under state law during the first 120 days a borrower is delinquent;

2. Servicers will be allowed to send certain early delinquency notices required under state law to borrowers that may provide beneficial information about legal aid, counseling, or other resources.
3. Allowing servicers to send the aforementioned early delinquency notices expands the protections already provided for under California's Homeowner's Bill of Rights ("HBOR");
4. The HBOR already prohibits a mortgage servicer from recording a Notice of Default until 30 days after it makes contact with the debtor to discuss foreclosure alternatives, or until 30 days after the credit completes its due diligence requirements if unable to make contact with the debtor.

<u>H. LIABILITY FOR FAILURE TO COMPLY WITH CFPB</u>:

- ✳ A debtor can file suit against a creditor under TILA section 129C(a) for non compliance with the ATR rules (so watch out for troubled members as they could claim that the credit union failed to make a reasonable, good-faith determination of their ability to repay at the time of the loan so this is all your fault);
- ✳ A debtor can stop a foreclosure by showing failure to comply with the TILA;
- ✳ A debtor may be entitled to his or her attorneys fees and costs;
- ✳ A lender may be liable for up to three (3) years of finance charges (for alleged violation of the ability-to-repay requirements, unless the creditor demonstrates that the failure to comply is not material);

* A debtor may also be entitled to actual damages (in an individual action or class action) up to a prescribed threshold (no statue of limitations if this is used as a "defense" to an action); .
    1. This is particularly disconcerting as what would the damages be for an unwarranted "bad credit score"?
    2. The difference between a good credit rate of interest and what the debtor had to settle for?
    3. What does that mean for a home loan which interest accumulates for a thirty (30) + year period of time?

* There is a three (3) year statute of limitations (as compared to one year for most other TILA violations) which starts from when the loan was originated.
* There is a three (3) year statute of limitations for State Attorney General who want to enforce a violation of section 129, 129B, 129C, 129D, 129E, 129F, 129G, or 129H, which may be brought not later than 3 years after the date on which the violation occurs.
* For high-cost loans an assignee generally continues to be subject to all claims and defenses, not only in foreclosure, with respect to that mortgage that the consumer could assert against the creditor of the mortgage, unless the assignee

demonstrates, by a preponderance of evidence, that a reasonable person exercising ordinary due diligence, could not determine that the mortgage was a high-cost mortgage.