

# PUBLICATION

---

## Heard on the Phone

October 30, 2013

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.
- 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.
- 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. See [http://files.consumerfinance.gov/f/201309\\_cfpb\\_smallcreditorflowchart\\_final.pdf](http://files.consumerfinance.gov/f/201309_cfpb_smallcreditorflowchart_final.pdf).
- 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.