

U.S. Consumer Financial Protection Bureau Commences Its Mortgage Reform Initiative

By Joseph T. Lynyak III

On July 9, 2012, the Consumer Financial Protection Bureau finally began its long-awaited regulatory overhaul of the U.S. residential mortgage market. From application processing to the ultimate disposition of mortgage assets in the secondary market, over the next six months the CFPB will completely revise how the home mortgage system functions.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) created the CFPB and consolidated various rulemaking and supervisory authorities in the agency, including the authority to implement new requirements under several existing federal mortgage laws. The Dodd-Frank Act also significantly amended the statutory requirements governing mortgage practices with the intent to limit certain practices by mortgage industry participants that allegedly contributed to the mortgage crisis.

This Pillsbury Alert provides an overview of the CFPB’s regulatory initiative, including a description of the several regulatory proposals, the statutory authorities being relied upon by the CFPB, as well as anticipated time frames for adopting final regulations and an implementation period for the mortgage industry.

In addition, this Alert provides some initial observations and recommendations for mortgage market participants whose future competitiveness will be significantly affected by the CFPB’s actions.

Background

The CFPB has announced that over this summer it will issue seven regulatory proposals addressing the following topics:

- RESPA-TILA Integration;
- High-Cost Mortgage Amendments;
- Mortgage Servicing;
- Loan Originator Compensation;

- Appraisals;
- Ability to Repay and Qualified Mortgage Definitions; and
- Escrows

The RESPA-TILA Integration and High-Cost Mortgage proposals will be published in the Federal Register in the next few days. As announced by the CFPB, the remaining five mortgage proposals will be issued in the next several weeks—with a goal of finalizing most of the proposals by January 21, 2013.

The explanatory materials accompanying the RESPA-TILA Integration and the High-Cost Mortgage Amendments are less than pellucid in their description of the history and development of these proposals, except that the CFPB indicates that it inherited several regulatory initiatives from the Federal Reserve Board (the “FRB”) and has continued working with those proposals while also expanding the overall scope of its mortgage initiative as a result of mortgage reforms mandated by the Dodd-Frank Act.

Several of the more significant prior mortgage proposals published by the FRB are as follows:

- *2009 Comprehensive Regulation Z Closed-End Proposal*—which remains the starting point for the RESPA-TILA Integration, as well as the proposed revisions to the disclosures for mortgage loans under Regulations Z and X.¹
- *2009 HELOC Proposal*—which proposed changes to Regulation Z governing disclosures for HELOCs.²
- *2010 Additional Regulation Z Amendments*—which proposed further modifications to a consumer’s right to rescission, loan modification procedures, high-priced mortgage escrows and reverse mortgage loans.³
- *FRB Escrow Proposal*—which proposed to amend Regulation Z to implement amendments made by sections 1461 and 1462 of the Dodd-Frank Act relating to escrow accounts.⁴
- *Ability to Repay and Qualified Mortgage Definition*—which proposed amendments to Regulation Z to implement Sections 1411 and 1412 of the Dodd-Frank Act to prohibit mortgage lenders from making mortgage loans without regard to the consumer’s ability to repay.⁵

Despite repeated assurances by CFPB staff that the mortgage initiative would begin in the first quarter of 2012, the administrative rule-making did not commence until the second quarter (although during this period CFPB staff was working on numerous disclosure forms and consulting with industry trade groups and other interested parties). However, as noted below, because of a deadline imposed by the Dodd-Frank Act, this delay in issuing several of the regulatory proposals for public comment has placed a significant burden on mortgage industry stakeholders to review and comment on what is estimated to be 2500 pages of regulatory materials.

¹ 74 Fed. Reg. 43232 (Aug. 26, 2009).

² 74 Fed. Reg. 43428 (Aug. 26, 2009).

³ 75 Fed. Reg. 58539 (Sept 24, 2010).

⁴ 76 Fed. Reg. 11598 (March 2, 2011).

⁵ 76 Fed. Reg. 27390 (May 11, 2011).

The CFPB's Seven Proposals

RESPA-TILA Integration—This proposal is the centerpiece of the CFPB's comprehensive initiative, and contains a disclosure scheme that integrates the requirements of RESPA and TILA. Among other things, this proposal combines TILA mortgage loan disclosures with Regulation X's Good Faith Estimate and the HUD-1 Settlement Statement (which was required pursuant to Section 1032(f) of the Dodd-Frank Act).⁶ It creates new nomenclature and replaces the current Regulation X and Regulation Z disclosure schemes with an entirely new paradigm. *Of particular note is that virtually every proposed disclosure is transaction specific.*

High-Cost Mortgage Amendments—This proposal lowers the annual percentage rate used to calculate the thresholds for high-cost mortgages, as well as expands the scope of coverage of high-cost mortgages to include all categories of home loans except reverse mortgages.⁷ Because one alternative approach contained in the RESPA-TILA proposal would eliminate virtually all exclusions from the definition of the finance charge for a mortgage loan—and hence would increase the number of mortgage loans that would constitute high-cost mortgages—this proposal includes several complicated alternatives that are intended to prevent a greater percentage of mortgages from becoming high-cost mortgages.⁸ In addition, the high-cost proposal imposes prepayment and late fee limits on high-cost mortgages. Finally, the proposal expands the requirement of providing a list of housing counselors to most home loan applicants, and would prohibit the origination of a high-cost loan in the absence of a certification that the borrower has received counseling.

Servicing—The CFPB's proposal will likely impose extensive procedural and substantive requirements on mortgage loan servicers, including requirements regarding force-placed insurance, error resolution, and payment crediting. In addition, the CFPB has indicated that it will propose model forms for loan servicing functions, including mortgage loan periodic statements and variable-rate adjustment notices.⁹ Further, the CFPB has indicated that it may propose rules on the maintenance of reasonable information management systems, early intervention for troubled and delinquent borrowers, and continuity of contact.¹⁰

Loan Originator Compensation—Section 1402 and 1403 of the Dodd-Frank Act added another onerous provision to the recent new regulatory limitations on the payment of compensation to loan originators by prohibiting certain compensation arrangements among mortgage loan originators, creditors and affiliates when compensation is also being paid directly by the borrower. However, in a notable clarification, the CFPB has indicated that it may exercise its exemptive authority and exempt certain payments of points and fees—at least for a five-year period. In addition, the CFPB may establish a standard of care for mortgage loan origination.¹¹

Appraisals—In conjunction with the federal banking regulators, the CFPB will issue a proposal regarding appraisals for higher-risk mortgages, appraisal management companies, and automated valuation models. In addition, the CFPB will also implement a provision of the Dodd-Frank Act requiring that appraisals be provided to borrowers for senior lien loans.¹²

⁶ Sections 1032, 1098 and 1100A of the Dodd-Frank Act.

⁷ The most significant change to the coverage of HOEPA is that the exception for purchase-money loans has now been eliminated.

⁸ Sections 1431, 1432, 1433 and 1450 of the Dodd-Frank Act.

⁹ Sections 1418, 1420, 1463, and 1464 of the Dodd-Frank Act.

¹⁰ The CFPB's April 9, 2012 SBREFA Panel outline contains draft forms and materials.

¹¹ The CFPB's May 9, 2012 SBREFA Panel outline raises the possibility of the creation of a partial exemption for the payment of points and fees.

¹² Sections 1471, 1473 and 1474 of the Dodd-Frank Act.

Ability to Repay and Qualified Mortgage Definitions—In perhaps the most significant rulemaking other than the RESPA-TILA Integration proposal, the CFPB will finalize the “ability to repay” requirement of the Dodd-Frank Act, including the terms and conditions necessary for a loan to constitute a “qualified mortgage.” (This regulation is being closely watched by the entire industry because it may determine for the foreseeable future whether low-to-moderate-income Americans will qualify for a home loan.)¹³

Escrows—Finally, the CFPB will issue a final rule (originally proposed by the FRB) requiring certain escrow account disclosures and exempting from the higher-priced mortgage loan escrow requirement loans made by certain small creditors.¹⁴

Legal Authority

The legal authority cited by the CFPB for undertaking its mortgage initiative is more expansive than the statutory authority typically provided to other federal agencies because of the aggregate breadth of discretion arguably provided to the CFPB. Essentially, the CFPB views the numerous statutory mandates and authorizations as providing it with the discretion to narrow, expand or exempt any class of procedural and substantive mortgage requirements contained in its proposals.¹⁵

This interpretive perspective can have salutary and detrimental effects. In regard to beneficial effects, the proper utilization of its broad discretion may enable the CFPB to remedy the numerous statutory conflicts between federal consumer laws that have existed over the years—RESPA and TILA being the most noteworthy examples. Similarly, the CFPB may provide relief to the industry in respect to loan originator compensation by exempting certain payments in order to avoid unintended disruptions to the mortgage origination system.

In regard to possible detrimental impacts on the mortgage industry, this same broad discretion can be utilized to subject mortgage industry participants to onerous, transaction-specific disclosure requirements that may not advance the goal of providing effective consumer shopping while imposing burdensome new requirements.

Implementing Time Frames

Even a cursory review of the CFPB’s two current proposals and its soon-to-be issued additional mortgage proposals leads one to conclude that *everything is about to change*. Specifically, with regard to applications, originations and servicing, the CFPB intends to substitute an expanded transaction-specific disclosure regimen for the current more limited disclosure scheme mandated by RESPA and Regulation Z.

In that regard, our discussions with numerous mortgage lenders and other stakeholders indicates that, at a minimum, existing loan origination and servicing platforms will require either complete replacement or substantial modification.

The CFPB, however, has not indicated that it will provide industry participants with sufficient implementation time to effect needed changes—only that it recognizes that some transition period will be needed. This issue is exacerbated by a provision in the Dodd-Frank Act that mandates that many of the TILA amendments become effective without the issuance of implementing regulations if the CFPB has not

¹³ Sections 1411 and 1412 of the Dodd-Frank Act.

¹⁴ Sections 1461 and 1462 of the Dodd-Frank Act.

¹⁵ Reinforced by several provisions of the Dodd-Frank Act, Section 129(p)(2) of the TILA does appear to provide the CFPB with broad supervisory and regulatory authority over the nation’s residential mortgage system.

finalized such regulations by January 21, 2013. (Should regulations be issued, impliedly the CFPB then has the flexibility to provide the industry a reasonable time to implement changes necessitated by the regulatory amendments.)¹⁶

Observations and Recommendations

The breathtaking scope of the CFPB's mortgage initiative will certainly present a challenge to the industry to absorb and to provide the CFPB with effective comments within the narrow window that the CFPB believes to be necessary. Further complicating the public comment process is the fact that the CFPB's seven proposals contain significant overlaps in coverage, and incorporate numerous references to the FRB's earlier proposals identified above prior to the transfer of the FRB's consumer protections to the CFPB and the date the CFPB's Director was appointed. From an administrative law perspective, this means that the total corpus of regulatory proposals to be reviewed (and commented upon) includes not only the suite of seven proposals that the CFPB is in the process of issuing for public comment, but the earlier FRB mortgage reform proposals as well.

We recommend that mortgage industry participants focus on the proposals that will directly affect their continued involvement in the mortgage market in order to maximize useful criticism and dialogue with the CFPB. For example, in the case of mortgage lenders, the RESPA-TILA Integration proposal is a priority. For mortgage servicers, the upcoming servicing regulations will not only require revisions in loan servicing systems but consideration of additional cost and expenses created as a result of the substantive obligations the CFPB proposes for mortgage servicers. (Whether these additional costs may be passed on to investors remains to be seen.) Similarly, additional limitations on loan originator compensation may dictate substantial restructuring of front-end loan solicitation business models—including the continued viability of such business models.

Finally, there is the issue of legal risk and liability. A review of the drafting approach taken by the CFPB indicates that it is drafting its regulatory amendments in a manner that may maximize potential liability for mortgage industry participants under the various federal consumer protection statutes that form the bases for the CFPB's mortgage initiative. Unless the CFPB elects to provide a reasonable degree of compliance flexibility during a transition period to permit mortgage industry participants to adjust new systems (including correcting disclosure errors without incurring liability), mortgage lenders and others may elect to reduce mortgage credit availability until such time as technical legal compliance concerns are completely resolved.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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¹⁶ Section 1400(c) of the Dodd-Frank Act.