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Fair Lending Laws: Evolving Regulatory and Litigation Landscape

Responding to the Latest Challenges in Fair Lending Enforcement

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Fed Loan Originator Compensation Rule

- Adopted under Truth in Lending Act.
  - 75 Federal Register 58509 (2010).

- Applies to applications received by creditors on or after April 1, 2011 for closed-end consumer credit transactions secured by a dwelling.
  - First or subordinate lien.
  - Dwelling does not have to be primary.
  - Closed-end reverse mortgages.

- Based on Truth in Lending section 129(l) authority, but roots in fair lending.
  - Intent to address discretionary mortgage loan pricing by eliminating yield spread premiums and overages.

Fed Rule—Loan Originator Basics

- Defined with respect to a particular transaction.
  - Activity in transaction, not in general, governs.

- Two elements:
  - Arrange, negotiate or otherwise obtain an extension of consumer credit for another person.
  - Do so for compensation or monetary gain or in the expectation of compensation or monetary gain.

- Managerial and administrative staff exception.
  - Commentary does not appropriately reflect that both elements are required.
  - As drafted, suggests either element triggers loan originator status.

Fed Rule—Three Main Elements

- Prohibition on compensation of loan originator for a covered transaction based on loan terms or conditions or a proxy for loan terms or conditions.
- Prohibition on compensation of loan originator for a covered transaction by both consumer and creditor (or another party other than consumer)—i.e., no dual compensation.
- Prohibition on steering consumer to a consummate a covered transaction based on receipt by loan originator of greater compensation, unless transaction is in consumer's interest.

Fed Rule—Discretionary Pricing

- Fed rule does not eliminate discretionary pricing.
  - In fact, the rule express provides that it does not limit a creditor' flexibility in setting loan terms.
- Fed staff informally confirmed mortgage brokers and loan officers can still establish loan terms with higher or lower rates or points from standard pricing, as long as their compensation is not based on the rates or points.
  - Fed staff noted fair lending issue.
- Industry approach.

Fed Rule—CRA

- A common practice to generate loans eligible for CRA credit is for a bank to incent loan officers with higher commissions for loans made in low or moderate-income areas.

- The Fed rule does not contain a CRA exception.
  - Fed staff informally advised that fair lending staff within Fed did not want Fed rule to address CRA.
  - Supplementary information to Fed rule includes the following: “The Board believes . . . that allowing compensation to vary with loan type, such as loans eligible for consideration under the CRA, would permit unfair compensation practices to persist in loan programs offered to consumers who may be vulnerable to such practices.”

Fed Rule—Liability

- The Fed adopted the rule under TILA section 129(l)(2) (15 USC § 1639(l)(2)) , which was added by the Home Ownership and Equity Protection Act (HOEPA).
- TILA liability provisions are not the clearest in the world and have not been revamped as TILA evolved beyond a disclosure statute.
- TILA section 130 refers to creditors and provides for:
  - Actual damages.
  - Statutory damages of not less than $400 or more than $4,000.
    - For a class action, lesser of $500,000 or 1% of net worth (DFA revised to lesser of $1.0 million or 1% of net worth).
  - Damages for violations of section 129 requirements equal to sum of all finance charges and fees paid by consumer.
  - Court costs and attorney's fees.

DFA Mortgage Originator/Steering Provisions

General

- Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) amends Truth in Lending Act to add both mortgage originator compensation provisions and steering provisions.
  - Public Law No. 111-203, sections 1401 to 1404.
  - Provisions are similar in some respects to Fed rule (as they include both originator compensation and steering provisions), but there are differences and certain differences are significant.
  - Underlying fair lending concern.

- Dodd-Frank provisions apply to a consumer credit transaction secured by a mortgage, deed of trust or other equivalent consensual security interest on a dwelling or residential real property that includes a dwelling, except for:
  - An open-end credit transaction; and
  - An extension of credit relating to a time share plan.

DFA Mortgage Originator/Steering Provisions
Effective

- Dodd-Frank expressly requires regulations to implement the steering provisions but not the mortgage originator compensation provisions.
- In supplemental information to Fed rule, Fed indicated it would implement Dodd-Frank provisions in a future rulemaking.
  - Fed or Bureau.
- Dodd Frank outside date for required regulations under Title XIV:
  - Must be prescribed in final form no later than 18 months after designated transfer date.
    - Based on designated transfer date of July 21, 2011: January 21, 2013.
  - Must take effect no later than 12 months after issued in final form.

DFA Mortgage Originator/Steering Provisions
Mortgage Originator

- Subject to exceptions, a "mortgage originator" is any person who for or in the expectation of direct or indirect compensation:
  - Takes a residential mortgage loan application;
  - Assists a consumer in obtaining or applying to obtain a residential mortgage loan; or
  - Offers or negotiates terms of a residential mortgage loan.
- Includes any person who represents to the public through advertising or other communication means that the person can or will provide any of the noted services.
- Creditors are not originators for the loan terms compensation and dual compensation prohibitions, and are originators for purposes of the steering prohibitions.

DFA Mortgage Originator/Steering Provisions

Steering Prohibitions

- The steering prohibitions of Dodd-Frank are broad, very different from the anti-steering provisions of Fed rule, and apply to mortgage originators, which includes creditors. The provisions prohibit:

- Steering a consumer to a residential mortgage loan that:
  - The consumer lacks a reasonable ability to repay, under Dodd-Frank repayment ability requirements to be implemented.
  - Has predatory characteristics or effects, such as equity stripping, excessive fees or abusive terms.

- Steering any consumer from a qualified mortgage for which the consumer is qualified to a non-qualified mortgage.

- Engaging in abusive or unfair lending practices that promote disparities among consumers of equal creditworthiness but of different race, ethnicity, gender or age.

DFA Mortgage Originator/Steering Provisions
Steering Prohibitions

- Mischaracterizing the credit history of a consumer or the residential mortgage loans available to a consumer.

- Mischaracterizing or suborning the mischaracterization of the appraised value of the security property.

- If the mortgage originator "is unable to suggest, offer or recommend to a consumer a loan that is not more expensive than a loan for which the consumer qualifies," discouraging the consumer from seeking a home mortgage loan secured by a consumer's principal dwelling from another mortgage originator.

DFA Mortgage Originator/Steering Provisions

Expanded Statute of Limitations

- TILA has general 1 year statute of limitations for violations, although it is subject to tolling.

- DFA expands statute of limitations from 1 to 3 years for various violations, including violations of the mortgage originator compensation and steering prohibitions.

- DFA authorizes state attorneys general to enforce various TILA provisions, including the mortgage originator compensation and steering provisions.
  - Attorneys general have a 3 year statute of limitations for enforcing the mortgage originator compensation and steering provisions.

DFA Mortgage Originator/Steering Provisions
Liability

- As noted above, TILA liability provisions are not the clearest in the world and have not been revamped as TILA evolved beyond a disclosure statute.

- TILA section 130 liability for violations of mortgage originator and steering provisions. Section 130 provides for:
  - Actual damages.
  - Statutory damages of not less than $400 or more than $4,000.
    - For a class action, lesser of $500,000 or 1% of net worth (DFA revised to lesser of $1.0 million or 1% of net worth).
  - Damages for violations of section 129 requirements equal to sum of all finance charges and fees paid by consumer.
  - Court costs and attorneys' fees.

DFA Mortgage Originator/Steering Provisions
Liability

- TILA section 130 refers only to creditors. Congress addressed that.
- Mortgage originator and steering provisions create liability under TILA section 130 for mortgage originators that are not creditors.
- The maximum amount of liability of a mortgage originator that is not a creditor for a violation of the mortgage originator compensation and steering prohibitions is the greater of:
  - The actual damages; or
  - An amount equal to 3 times the total amount of direct and indirect compensation or gain accruing to the mortgage originator, plus the costs to the consumer of the action (including reasonable attorneys' fees).

DFA Mortgage Originator/Steering Provisions

"Defense to Foreclosure"

- DFA adds a "defense to foreclosure" provision for certain TILA violations, including mortgage originator compensation provisions, but not the steering provisions.

- Specifically, when a creditor, assignee or other holder of a residential mortgage loan, or anyone acting on their behalf, initiates a judicial or nonjudicial foreclosure, or any other action to collect the debt, a consumer may assert a violation *by the creditor* of the mortgage originator compensation provisions as a matter of defense by recoupment without regard to the 3 year statute of limitations.
  - Amount of recoupment or setoff is limited to amount of damages that consumer would be entitled to under TILA section 130.
  - What about violation of mortgage originator compensation provisions by a mortgage broker and not a creditor?

DFA—Home Mortgage Disclosure Act

- DFA section 1094 amends HMDA to significantly expand the data reporting requirements. New data elements include:
  - The age of the borrower or applicant.
  - The credit score of the borrower or applicant, in such form as the Bureau of Consumer Financial Protection (Bureau) may prescribe.
  - The total points and fees payable at origination, as determined by the Bureau.
  - The difference between the annual percentage rate for a loan and a benchmark rate or rates for all loans.
  - The term in months of any prepayment penalty or other fee or charge payable on repayment of some or all of the principal in advance of scheduled payments.
  - The value of the real property securing the loan.
  - The actual or proposed term in months of any introductory period after which the interest rate may change. *Continued:*

DFA—Home Mortgage Disclosure Act

- New HMDA data elements *(continued)*:
  - The actual or proposed loan term to maturity.
  - The presence of contractual terms or proposed contractual terms that would allow the borrower or applicant to make payments other than fully amortizing payments during any portion of the loan term.
  - The channel through which the application was made, including retail, broker, and other relevant categories.
  - As the Bureau may determine to be appropriate:
    - A unique identifier that identifies the loan originator, as assigned pursuant to the S.A.F.E. Mortgage Licensing Act of 2008.
    - A universal loan identifier.
    - The parcel number that corresponds to the real property pledged or proposed to be pledged as collateral.
  - Such other information as the Bureau may require.

The Bureau

- Title X of the Dodd-Frank Act is the Consumer Financial Protection Act of 2010 (CFP Act).
  - The CFP Act creates the Bureau of Consumer Financial Protection (Bureau).
  - Bureau has significant powers to address consumer financial products and services, including residential mortgage lending.

- The Bureau is granted the authority to regulate the offering and provision of consumer financial products or services under Federal consumer financial laws, including:
  - HMDA.
  - Equal Credit Opportunity Act (ECOA).
    - But not the Fair Housing Act.

Bureau—Basics

- Authority will be transferred to the Bureau on the designated transfer date.
  - The Treasury Department established July 21, 2011 as the designated transfer date.
- The CFPB is an independent bureau within the Federal Reserve Board.
  - The Financial Stability Oversight Council, created by the Dodd-Frank Act, has the authority to set aside a final regulation of the Bureau.
  - The Director of the Bureau is appointed by the President, and confirmed by the Senate, for a five-year term.

Bureau—Offices

- Offices to be created within the Bureau include:
  - Office of Minority and Women Inclusion.
  - Office of Financial Protection for Older Americans.
  - Office of Fair Lending and Equal Opportunity.
  - Office of Financial Education.
  - Office of Service Member Affairs.

- The first two Offices must be established not later than January 21, 2012.

- The last three Offices must be established not later than July 21, 2012.

Bureau—Rulemaking Authority

- Bureau given broad rulemaking authority to administer and carry out the purposes and objectives of federal consumer financial laws.

- Bureau must consult with the appropriate prudential regulators or other federal agencies in connection with rulemaking with respect to prudential, market or systemic objectives administered by the agencies.

- Bureau also must coordinate with the CFTC, FTC, other federal agencies and state regulators as appropriate to promote consistent regulatory treatment of consumer financial and investment products and services.

Bureau—Direct Authority

- Bureau has direct authority with respect to federal consumer financial laws over certain covered persons in connection with consumer financial products or services:
  - Insured depository institutions and credit unions with assets exceeding $10 billion.
  - Nondepository institutions and individuals.
    - Bureau must consult with FTC and by July 21, 2012 issue a rule identifying nondepository institutions that are covered persons.
  - Service providers to the foregoing.

Bureau—Non-Direct Authority

- Prudential regulator retains authority with respect to federal consumer financial laws over insured depository institutions and credit unions with assets of $10 billion or less.
  - Bureau may require reports from such parties, but must use existing reports to fullest extent possible.

Bureau Relief Authority

- In an action or adjudication proceeding under any Federal consumer financial law, Bureau may obtain appropriate legal or equitable relief including, without limitation:
  - Rescission or reformation of contracts.
  - Refund of monies or return of real property.
  - Restitution.
  - Disgorgement or compensation for unjust enrichment.
  - Payment of damages or other monetary relief.
  - Public notification regarding the violation, including the costs of notification.
  - Limits on the activities or functions of the person.
  - Civil money penalties.

Bureau and Civil Money Penalties

- With regard to civil money penalties, Congress established the following:
  - For any violation of a law, rule, or final order or condition imposed in writing by Bureau, up to $5,000 per day.
  - For any person that recklessly engages in a violation of a Federal consumer financial law, up to $25,000 per day.
  - For any person that knowingly violates a Federal consumer financial law, up to $1,000,000 per day.

The HUD Complaint and Investigation Process

- When a person or entity files a Complaint with HUD, the agency immediately reviews it for jurisdictional basis.
- If HUD assumes jurisdiction, it assigns a Case Number and serves the Complaint upon the Respondent.
- The Complaint is typically delivered to the Respondent by mail, with a covering letter from HUD's Office of Systemic Investigations.
- The Respondent is required to make a formal response to the Complaint, which will be akin to an Answer in civil litigation.
- While the regulations provide that an Answer must be made within 10 days of receipt of the Complaint, a reasonable extension is often granted.

The HUD Complaint and Investigation Process

- What should the Answer include?
  - It should fully address the allegations of the Complaint, with admissions, denials and affirmative defenses as appropriate.
  - The content of the Answer will be dictated by the strength or weakness of your defenses to the case.
  - Exhibits are not prohibited, but absent them being dispositive, they should not be included.
  - The Answer must be verified.

The HUD Complaint and Investigation Process

- HUD then pursues in its investigation of the allegations of the Complaint and Answer. Investigation is to conclude within 100 days.
  - At least one investigator is assigned from HUD's Office of Systemic Investigations.
  - HUD has the authority to interview representatives of both sides, conduct depositions, issue non-party subpoenas and compel the production of documents.
- HUD's typical course at the outset is to schedule interviews with what it considers to be key players within the employ of the Respondent.
  - HUD typically follows up with document demands, often seeking documents identified in the interviews.

The HUD Complaint and Investigation Process

- After HUD concludes its investigation, it issues a finding of “reasonable cause” or “no reasonable cause” to believe that the Respondent engaged in acts in violation of the Fair Housing Act.
- If reasonable cause is found, the matter will be remanded to an Administrative Law Judge for hearing, unless either side elects to have the case heard in federal court.
  - An ALJ’s decision is subject to review by the Secretary of HUD.
  - If no reasonable cause is found, the Complainant can either seek reconsideration with HUD or commence a federal court action on its allegations.

The Conciliation Process

- Section 810(b) of the FHA (42 U.S.C. § 3610(b)) requires HUD to attempt Conciliation -- a mediation process under the auspices of HUD.
- The objective of Conciliation is to bring about a compromise on the issues raised in the Complaint.
- Conciliation is usually attempted early on. Participation is voluntary.
- The Conciliation process is intended to be confidential, and no statements made by a party in conciliation may be used against it.
- A neutral Conciliator from within HUD is appointed to administer the process.
- If no Conciliation agreement is reached, the investigation continues.

The Conciliation Process

- If a compromise is reached, the parties and HUD negotiate and agree upon the essential terms of the Conciliation Agreement.
- HUD will not sign off on the Conciliation Agreement unless it includes provisions for relief to protect the public interest.
- A signed Agreement terminates the investigation of the Complaint as well as the Complainant's right to pursue relief via administrative hearing or a civil trial.
- HUD retains the power to enforce the terms of the Agreement.
- A private settlement between Complainant and Respondent does not require HUD to terminate its investigation.

NCRC Complaints Now Before HUD

- In early December, 2010, the National Community Reinvestment Coalition (NCRC) submitted complaints to HUD alleging FHA violations by 22 mortgage lenders.
- NCRC reportedly entered into discussions with more than a dozen other lenders on the same issue, without HUD involvement.
- Central theme-- unlawful credit score overlays in the origination process for FHA-insured loans.
- Claims of failure to lend to borrowers with credit scores below 620 (in some cases 640).

NCRC Complaints Now Before HUD

- How have the 22 lenders facing the HUD investigation responded?
  - As of now, no Conciliation Agreements have been reported.
  - Certain lenders have denied imposing any credit score overlay in their application process.
  - Without conceding the use of such credit score overlays, other lenders have also offered economic justifications for the propriety of such overlays.

NCRC Complaints Now Before HUD

- Economic justification for use of credit score overlays in connection with FHA-insured loans
  - FHA insurance fund has fallen below the statutory minimum.
  - FHA insurance is not sufficient to make a lender whole in case of borrower default leading to foreclosure.
  - Congress (Dodd-Frank) and regulators were recently critical of lenders making loans to borrowers with shaky credit history.

NCRC Complaints Now Before HUD

- Economic justification for use of credit score overlays in connection with FHA-insured loans (cont.)
  - Statistics bear out that borrowers with credit scores below 620 are much more likely to default.
  - Increased default rates can lead to suspension of lenders' branches or termination of FHA-approved status entirely.
  - HUD's signals have been less the clear on this issue in the past.