CONSUMER FINANCIAL SERVICES ALERT

NOVEMBER 12, 2013

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CFPB to Hold Auto Finance Forum

The CFPB will hold a forum on auto finance in Washington, D.C. on November 14, 2013. According to the CFPB, the forum will include a discussion with consumer groups, industry representative and members of the public. The forum comes on the heels of several actions taken by the CFPB related to auto finance. The CFPB has taken enforcement action against a supervised entity for its indirect auto lending program. The CFPB also released guidance on indirect auto lending and complying with the Equal Credit Opportunity Act (*see* April 2, 2013 *Alert*). More recently, the CFPB responded to a letter from members of Congress requesting that the CFPB provide details on the methodology used to determine whether disparate impact is present in an auto creditor's portfolio, its decision to issue guidance rather than using the rulemaking process, and the CFPB's coordination with other federal regulators including the FRB and FTC in issuing guidance on fair lending and indirect auto lending. In its response, the CFPB noted that it has many tools at its disposal "when dealing with practices that cause consumer harm."

CFPB Issues Advance Notice of Proposed Rulemaking on Debt Collection Rules

The CFPB published an advance notice of proposed rulemaking on debt collection rules. As part of the Dodd-Frank Act, the CFPB was given authority to issue rules for debt collection under the FDCPA, which had not authorized any agency to make any substantive rules following its enactment in 1977. Under the Dodd-Frank Act, the CFPB was also given the authority to issue regulations related to unfair, deceptive or abusive acts or practices in connection with consumer financial products or services. The CFPB is seeking information to help with the development of rules for creditors, debt buyers, and third-party collectors when transferring information related to debt when debts are sold or placed for collection with third parties, the content, form and delivery of validation notices under the FDCPA, and communications with debtors given advances in communication technology (*e.g.*, social media and smartphones). For example, the CFPB is seeking comment on what additional information should be included in validation notices to help consumers recognize whether the debts being collected are owed by them and what potential privacy, security or other risks of harm to consumers may arise from use of technology. The CFPB is also seeking comment on the prohibition in the FDPCA on contacting debtors at unusual or inconvenient times. The CFPB noted that the advent of mobile phones "complicates the determination of what times are unusual or inconvenient." Of import, the CFPB is seeking comment on whether it should use its rulemaking authority to establish new requirements and limitations on originating creditors and those creditors collecting their own debt. Comments are due by February 10, 2014.

CFPB Settles with Mortgage Company over Loan Originator Compensation Incentives

The CFPB announced a proposed consent order against a mortgage company and two of its senior officers, alleging that the mortgage company, through the actions of such officers, steered consumers into mortgages with higher interest rates in violation of the rules governing loan originator compensation. The settlement follows a complaint filed by the CFPB alleging that the mortgage company paid loan officers quarterly bonuses that varied based on the interest rate of the loans they offered to borrowers in violation of the Consumer Financial Protection Act and the Federal Reserve Board's 2010 compensation rule, which prohibits any person from compensating a loan originator based on a term or condition of a mortgage loan (*see* August 6, 2013 *Alert*). The CFPB also alleged that the mortgage company did not refer to the quarterly bonus program in its written compensation agreement with its loan officers, nor did the mortgage company refer to the quarterly bonus plan in any written policies—in violation of the CFPA and the record retention requirements of Regulation Z.

The terms of the consent order require the mortgage company to pay $4 million in civil money penalties and provide restitution of over $9 million to consumers. The mortgage company is also required to end unlawful compensation practices, and for 3 years following the effective date of the consent order, to submit compliance reports as requested by the CFPB and to create, retain and make available to the CFPB upon request all records necessary to demonstrate full compliance with the consent order, including records detailing all compensation paid to loan originators and how such compensation was calculated.

CFPB Issues Interpretative Rule and A Guidance Bulletin on HOEPA Homeownership Counseling Lists

The CFPB issued an interpretive rule describing the data instructions for lenders to use in complying with HOEPA. The HOEPA rules require, among other things, that lenders provide applicants with a list of HUD-approved housing counseling agencies. In order to comply with the requirements to provide a list of homeownership counseling agencies under the HOEPA rules, lenders have two options: (1) use a tool developed and maintained by the CFPB on its website, or (2) use data made available by HUD and the CFPB to generate a list of homeownership counseling organizations. The interpretive rule provides instructions for lenders to use in complying with the second option. The rule is effective January 10, 2014.

In conjunction with the interpretative rule, the CFPB issued a guidance bulletin in response to concerns from the industry that lenders who choose the second option—to use data made available by HUD and the CFPB. The bulletin provides that while lenders work to incorporate the second option into their systems, they may direct borrowers to the CFPB's housing agency website to obtain a list of housing counselors.

OCC Releases Guidance on Third-Party Relationships

The OCC issued guidance to national banks and federal savings associations in assessing and managing risks related to third-party relationships. The OCC defines a third-party relationship as "any business arrangement between a bank and another entity, by contract or otherwise." In the guidance, the OCC states that a bank's failure to have an effective risk management process that is "commensurate with the level of risk, complexity of third-party relationships, and organizational structure of the bank may be an unsafe and unsound banking practice." Specifically, the OCC's supervisory expectation is that a bank will (throughout the life cycle of each third-party relationship) manage its third-party relationship risks by taking the certain actions, including developing a plan that outlines the bank's strategy, identifies the inherent risks of the activity, and details how the bank will select, assess, and oversee the third party; performing proper due diligence to identify risks and select a third-party provider; conducting ongoing monitoring of the third party's activities and performance; and conducting independent reviews of the risk management process to enable management to assess that the Bank's process aligns with its strategy and effectively manages risks from third-party relationships, among other things.

FHFA Restricts Force-Placed Insurance Practices

The FHFA has directed Fannie Mae and Freddie Mac to prohibit servicers from being reimbursed for expenses associated with captive reinsurance arrangements. The directive follows the FHFA's proposal in March 2013 (*see* April 2, 2013 *Alert*) to ban mortgage lenders and servicers from receiving commissions or other remuneration associated with maintaining force-placed insurance with certain insurers and from receiving reinsurance premiums through reinsurance entities affiliated with the lender or servicer. The ban is intended to reduce the costs for Fannie Mae and Freddie Mac and comes after receiving input from the Regulatory Working Group established by the FHFA and comments received from the public to the proposal.

Fourth Circuit Holds Borrower Waived Rights Under ECOA

The United States Court of Appeals for the Fourth Circuit affirmed dismissal of a claim under the Equal Credit Opportunity Act brought by plaintiff, a woman whose husband took out a commercial loan, alleging that the lender required her to sign as a guarantor on that loan, and on subsequent loan restructuring agreements made after a series of defaults. Each agreement contained a provision by which she waived all claims against the lender, expressly stating that the waiver was made after consultation with counsel—though plaintiff alleged that her attorneys had conflicts of interest based on their concurrent representation of her husband. The lawsuit claimed that the lender's spousal cosigning requirement violated both ECOA and Maryland's analogous state statute.

Recognizing that ECOA generally prohibits spousal signature requirements when the spouse would qualify on the strength of his own credit, the Fourth Circuit recognized several exceptions to this prohibition: (1) when a spouse would not independently qualify for the loan; (2) when the spouse "owns or co-owns the entity benefitting from the loan"; and (3) when the spouses co-own collateral pledged for a loan. The Fourth Circuit assumed, without deciding, that guarantors were considered the equivalent of "applicants" for credit under ECOA (though one concurring judge disagreed with this assumption). The Court then ruled that none of the ECOA exceptions applied: plaintiff's husband was not individually evaluated for creditworthiness; plaintiff was not a "de facto" owner of the business for which the loan was sought; and ECOA only applied to a pledge of collateral when that pledge related to a loan that would benefit the pledged property. Thus, if plaintiff had not waived her right to sue, she would have stated a claim.

However, the Fourth Circuit ruled that plaintiff did waive the claim in the loan restructuring agreements. Plaintiff argued that enforcing a broad waiver of "any and all claims" would undermine ECOA, but the Court disagreed, reasoning that while such a waiver would be impermissible in an *initial* extension of credit, ECOA did not prevent lenders from requiring waiver as a precondition for *restructuring* agreements. The Fourth Circuit recognized that not allowing waiver in this context may hurt defaulting borrowers, as many lenders would choose not to negotiate restructuring agreements if such waivers were not allowed. Finally, the Court held that plaintiff stated no facts to support her argument that the attorneys' alleged conflict of interest "prompted her repeated decisions to waive her ECOA rights."

Tentative Settlement Reached in Disparate Impact Theory Suit

A tentative settlement has been reached in the case against a New Jersey township brought by a group of neighborhood residents challenging the township's redevelopment plans based on the disparate impact theory. The township planned to replace older housing in a low-income, high-crime neighborhood with newer housing. The settlement requires the approval of the town council. However, the scheduled vote was tabled in order to "clean up language in the agreement," and that the town council is expected to settle the case soon. Settlement talks gained increased urgency after the Supreme Court granted certiorari following a decision by the United States Court of Appeals for the Third Circuit allowing the action to proceed under a disparate impact theory (*see* June 25, 2013 *Alert*). The Supreme Court set oral argument for December 4, 2013.

In 2008, residents filed suit in the United States District Court for District of New Jersey alleging that the township's redevelopment activity violated the Fair Housing Act because of its disparate impact on the township's minority population. The lower court granted summary judgment in favor of the township, finding neither a *prima facie* case of discrimination nor any alternative course of action that would have reduced the impact. The Third Circuit, however, reversed the lower court ruling that the residents adequately made a *prima facie* case that the township violated the FHA under a disparate impact theory.

The case has drawn widespread interest; particularly since the Supreme Court granted certiorari, more than 30 parties have filed *amicus curiae* briefs. Notably, the Supreme Court granted certiorari only as to the petition's first question: "Are disparate impact claims cognizable under the Fair Housing Act?" The petition's second question concerned how, if cognizable, such claims should be analyzed. The case has important implications given the use of the disparate impact doctrine by many federal agencies in addressing alleged discrimination in mortgage lending. Recently, HUD adopted a rule on the disparate impact doctrine (*see* February 19, 2013 *Alert*) and the CFPB reaffirmed that the disparate impact doctrine was applicable when the CFPB exercises its supervisory and enforcement authority (*see* May 1, 2012 *Alert*).

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