Consumer Finance Monitor (Season 3, Episode 39): A Close Look at the CFPB's Mortgage-Related Exam Findings in Summer 2020 Supervisory Highlights

Speakers: Chris Willis, Rich Andreano, Jr., and Reid Herlihy

Chris Willis:

Welcome to the Consumer Finance Monitor podcast where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. I'm your host Chris Willis and I'm the deputy practice leader of Ballard Spahr's Consumer Financial Services Group and I'll be moderating today's program.

Chris Willis:

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Chris Willis:

Now today, our subject is going to be the most recent edition of the CFPB's supervisory highlights and this most recent edition, like many of the ones that came before it, had a lot to say about mortgage both on the origination and on the servicing side. So to join me and talk to our audience about those elements of the supervisory highlights I have two of my partners, Rich Andreano who's one of the practice leaders of our Mortgage Banking Group, and Reid Herlihy who's one of the partners in our Mortgage Banking Group. So Rich and Reid welcome to the podcast.

Rich Andreano:

Thank you, Chris.

Chris Willis:

So I appreciate you guys joining me today. And Rich, let me start with you. What did the supervisory highlights, this most recent edition, have to say about mortgage origination?

Rich Andreano:

It focused on two areas. One that it's been a hot area for a while and that's redlining obviously in the fair lending context and another fair lending issue that often gets overlooked by the industry, the consideration of public assistance income. Now, in the redlining area as you and I know for matters we've been involved with, with some of our clients, the Bureau for some time has been assessing whether to take action against a non-bank mortgage lender based on redlining concerns. And that shoe finally dropped this past July when the Bureau filed its first ever redlining complaint against a non-bank mortgage company, Townstone Financial. Now it's interesting that the CFPB refers to Townstone as a mortgage lender and a broker while Townstone's position is that it's just a broker.

Rich Andreano:

In any event, switching gears to the supervisory highlights the Bureau notes that in conducting supervisory activity of both bank and non-bank mortgage lenders, so again non-banks included, examiners observed that the lenders violated the Equal Credit Opportunity Act, or ECOA, and its regulation, regulation B, by intentionally redlining, majority minority neighborhoods in two metropolitan statistical areas. Now they don't identify what the areas are. As you know in the supervisor highlights they give you bits of facts but not precise facts. Now, the Bureau states that the lenders engage in extra practices directed at prospective applicants that may have discouraged reasonable people from applying for credit but then they dig a little deeper and they say that examiners believed the lenders use marketing materials that would discourage reasonable persons on a prohibited basis from applying to lenders for a mortgage loan.

Chris Willis:

Thanks Rich. So what was the evidence that the Bureau cited in the supervisory highlights that led to this conclusion of redlining that you just told us about?

Rich Andreano:

There were a few things and for those who follow red lining complaints and when they focus on advertising these points will probably sound familiar to you. One, they noted that the lenders did advertise in a publication that had wide circulation within the applicable MSAs and they did it on a weekly basis for about two years but that these ads all prominently featured only a white model. Similarly, they say in marketing materials that the lenders provided to their loan originators to be distributed to potential customers that the materials featured almost exclusively white models. And finally, they noted specifically in materials that were going to be distributed at open house that were being held the materials had headshots of the mortgage professionals and the way the supervisory highlights summarize it that all of these professionals appeared to be white. So. Those were three specific factors.

Rich Andreano:

They also note that there was a direct marketing campaign that the lenders engaged in that focused mainly on majority white areas in the MSAs and to the Bureau that provided additional evidence of an intent to discourage prospective applicants on a prohibited basis, in other words the minority areas of those MSAs. Besides that though as is typical, the Bureau also looked at two sources of data, the Home Mortgage Disclosure Act and U.S. census data. Obviously the census data lets us know what is in or the compilation of the particular census track. What they found after doing what they referred to as a general and refined peer analysis is that these lenders received significantly fewer applications from majority, minority and high minority neighborhoods then what the Bureau considered to be their peers. Now what's a majority, minority as it might sound it's over 50% of the particular area has a minority population. A high minority area is where over 80% of the particular area has a minority population. Now these claims are very common in redlining actions brought by both the Bureau and also the Department of Justice.

Chris Willis:

So Rich as you said, the kind of factors that you just identified you would see in all of the publicly filed complaints by the CFPB and by Department of Justice in redlining cases. And you also noted that the supervisory highlights characterize these as claims of intentional discrimination which is what a redlining claim is. Why then are we seeing this in supervisory highlights and not in an enforcement action?

Rich Andreano:

It's very interesting and as you know under Equal Credit Opportunity Act the Bureau and the federal banking agencies have to actually refer a matter to the Department of Justice when they believe that a creditor has engaged in a pattern or practice of discouraging or denying applications in violation of the statute. And at its core, a redlining claim is you're discouraging applications and that's what they assert here. Basically the assertion is that the lenders involved here used marketing that would discourage minorities for applying to them for a loan. Based on it this clearly looks like a refer to DOJ case.

Rich Andreano:

Now, had a referral occurred and DOJ took over the matters presumably the Bureau would have sat on the sidelines and not taken supervisory action. So, the only assumptions are either a referral didn't occur or perhaps more likely referrals did occur and for whatever reason the Department of Justice decided not to pursue these specific matters. Now as we noted early on, the Bureau decided to actually take an enforcement action which resulted in the filing of a complaint in federal court against Townstone Financial, the first ever redlining case against a non-bank mortgage lender. And in the past, the Bureau has not been shy about bringing enforcement actions to pursue fair lending matters. So, the fact that they handled these solely in the supervisory context and not in the enforcement context is frankly a bit puzzling.

Chris Willis:

Yeah. So, turning back to the issue of public assistance income that's one that sometimes people will forget about because it's not as obvious of a protected characteristic under ECOA, what did the examiners find to be an issue there?

Rich Andreano:

And here was the basic prohibition in a ECOA reg B that you can't discriminate based on the fact that all a part of an applicant's income derives from a public assistance program. And quick what that is, that concept is broadly defined in reg B just so you know what we're talking about. It's any federal state or local government assistance program that provides a continuing periodic income supplement. And that's whether this is based on an entitlement or a need. And examples that reg B provides, and this is only examples it's not an exhaustive list, would be common forms that you see, the temporary aid to needy family, food stamps, rent, mortgage supplement or assistance programs, very common social security and supplemental security income, and also unemployment compensation.

Rich Andreano:

Now, key here when it comes to income and this is where sometimes creditors get themselves in trouble with this type of income is you're allowed to consider the amount and the probable continuance of income when you are evaluating an application. But when you look at the various components of an applicant's income you're not allowed as a creditor to automatically discount or exclude from consideration any protected income. To discount or exclude it has to be based on an evaluation of the applicant's actual circumstances. What was found in these cases is that the Bureau believed that the lenders were automatically excluding certain forms of public assistance income from consideration when evaluating borrowers for mortgage modification programs. So this presumably was borrowers who were having trouble making their mortgage payments, were applying for a modification and that the lenders were excluding automatically certain types of public assistance income without assessing their particular characteristics.

Rich Andreano:

Now, apparently the public assistance involved in these cases, I don't know if it was limited to this but the Bureau notes unemployment compensation and food stamps. Now, interestingly, the lenders acknowledged they did this even though they didn't have written policies directing the practice. So, the way the Bureau must've found it is I assume they were assessing their loss mitigation activities which is an important servicing function that they do examine and they must have caught it that way. They also found some cases where the applicant listed certain forms of public assistance in the loss mitigation application itself and the lender simply excluded it just automatically without assessing. And some of these applicants were denied loss mitigation options due to insufficient income.

Rich Andreano:

Now, not cited by the Bureau in these particular cases but where we've also found lenders get into trouble so wanted to highlight it is asking for proof that certain types of income such as social security disability income will continue. Basically the general rule you follow, unless the type of income the consumer is receiving has in fact a specific limitation on how long it can be paid out you must assume that that income will continue and you can't ask for proof that the income will continue. And I

know by comparison while obviously we confirm that the applicant is employed and particularly nowadays that they have no belief that there will be change in their employment status, once we confirm that the assumption is that employment income will continue in perpetuity even though that employee absolutely no guarantee of future employment. You have to look at public assistance and other income, disability income such in the same manner. Unless it has a defined end date you have to assume it will continue.

Chris Willis:

Thanks a lot Rich. So, returning to you on the mortgage servicing front what did the CFPB address in this most recent supervisory highlights with respect to that?

Reid Herlihy:

Yeah thanks Chris. I guess I should point out at the outset I mean really probably the most remarkable thing here for mortgage servicers in this edition of supervisory highlights is that it doesn't focus on loss mitigation and foreclosure. For all of you that have been paying attention that's really been the focal point in a lot of cases. The only thing discussed in mortgage servicing and just about every supervisory highlights addition since the dawn of the supervisory highlight. So really for the most part this edition covers a variety of really more routine violations that haven't really been hot button issues over the years. I say that though with the exception of the first topic which deals with certain periodic statement issues for consumers in bankruptcy which our experience has really been a bonafide dilemma for a lot of servicers and their ability to technically comply in certain instances.

Reid Herlihy:

So I'll jump right into it. As I indicated the first topic here covers failures by servicers to provide the required periodic statements for certain borrowers in BK which is required pursuant to the April, 2018 amendments to the CFPB servicing rules. And notably the report states that in some cases these failures were caused by an inability to reconcile bankruptcy accounting records that they had to import from third parties in a way that's necessary to accurately convey the required informational elements on the chapter 12 and 13 periodic statements and to be able to do so in a timely manner to get the periodic statements out as required by the regulation.

Chris Willis:

It sounds like there could be some significant underlying issues with bankruptcy periodic statements. Do you have a sensory for the scope of this problem for the servicing industry?

Reid Herlihy:

Yeah Chris, we've heard this being particularly challenging for a lot of servicers especially at the outset of the effective date of this regulatory amendment. Specifically that ability to reconcile bankruptcy accounting information in a timely and accurate way that you need to in order to issue timely and accurate periodic statements with all of these very complicated data elements and particularly those required for chapter 12 and chapter 13 periodic statements has been a real issue. As conveyed in the supervisory highlights document some servicers this has caused them to decide to simply not issue these statements while these problems were being resolved out of fear of the additional risk exposure for conveying inaccurate information on a periodic statement to borrowers in bankruptcy.

Reid Herlihy:

This kind of issue could also prompt servicers to simply omit certain required information from the statements or perhaps use other creative techniques to caveat or disclaim certain amounts reflected in these statements for which they may be uncertain. So it's a worrisome issue and I think there was a lot of focus here on violations perhaps of just the reg X periodic statement rules or the bankruptcy code but it raises FDCPA liability. It raises UDAP issues as well. So hopefully this is something that

the CFPB can meditate on and perhaps in the future revisit these amended requirements for periodic statements to borrowers in bankruptcy and hopefully we can get some relief from them.

Chris Willis:

So in the meantime what else was going on with respect to mortgage servicing and these supervisory highlights?

Reid Herlihy:

Yeah, really the next [inaudible 00:15:44] go over here are pretty routine issues and clear violations of basic elements of the requirements. So, the next issue cited violations of reg X for servicers that charged premiums for force-placed insurance despite the fact that the borrower or the borrower's insurance company had in fact given evidence of the required coverage to the servicer. And it just sounds like the servicers didn't properly update their systems to reflect the insurance coverage and then incorrectly charged the borrower for force placed insurance coverage. So again, as with a lot of these issues in this edition it's simply a clear violation of a very basic requirement of the force placed insurance regulations.

Reid Herlihy:

There's another on the subject of force placed insurance, another finding that cited servicers for failing to properly cancel force placed insurance and then refund those premiums for periods where the consumer provides evidence of overlapping coverage and having to do that within 15 days of receiving that evidence. Again, a basic violation and the CFPB examiners attributed these violations to just failure to process proof of insurance and perhaps having inadequate staffing.

Reid Herlihy:

The CFPB also cited violations of the escrow account administration requirements and reg X. According to the supervisory highlights document one or more servicers violated section 1024.17 by not properly trying to recoup escrow account shortages and deficiencies. And specifically the examiners found that for borrowers with either shortages or deficiencies that were in amounts equal to or greater than one month escrow account payment the servicers had included an option for the borrower to repay as simply a lump sum in the borrower's annual escrow account statements. And so, reg X states that for those types of shortages or deficiency amounts you're not permitted to try to recoup those amounts through a lump sum payment. Again, plain language of the rule just something that was clearly missed by the servicer.

Reid Herlihy:

Next, the CFPB very generally cited servicers for a variety of violations in connection with or soon after servicing transfers and it really just has a list of things that they found. And for example, it says servicers failed to provide an accurate, effective date for the transfer of servicing in the servicing transfer notice, a basic element of that requirement. That the servicer failed to exercise reasonable diligence to obtain documents and information necessary to complete a loss mitigation application. That servicers failed to credit a periodic payment as of the date of receipt. That also when acting as a debt collector simply failing to provide a debt validation notice in accordance with the FDCPA's timing requirements.

Reid Herlihy:

And so again, there was just a general statement that they attributed these types of post transfer violations to errors during the onboarding process and inadequate policies and procedures. And then finally the CFPB cited one or more servicers for simply not sending the consumers the mortgage loan ownership transfer disclosure required in section 1026.39 of reg Z. And there really isn't any added context here, it just seems to have been a missed requirement.

Chris Willis:

So Reid you've run through a laundry list of black letter mortgage servicing issues. What do you think are the takeaways from this report overall for the servicing side of the mortgage industry?

Reid Herlihy:

Yeah Chris, I mean really again it's just a lot of routine issues that involve clear requirements that probably just haven't been on the forefront of everyone's attention through a lot of the regulatory amendments over the past few years. And then during COVID obviously there's a lot of changes and a lot going on for the servicing industry to focus on. So I don't know, maybe we just look at this as a good reminder to not lose sight of the basics and the blocking and tackling that you have to do, that there really are important regulatory requirements out there that are relatively easy to comply with you just have to be sure to do the basics correct and to keep an eye on them instead of just focusing on these hot button issues.

Chris Willis:

Well, thanks a lot Reid for those insights and Rich thank you for yours as well on the origination side and particularly with regard to the redlining issues that have been raised by the CFPB. And now of course, we want to thank our audience for listening in as well. Be sure to visit our website at ballardspahr.com where you can subscribe to both our podcasts in Apple podcasts, Google Play, Spotify, or your favorite podcast platform and our blog consumerfinancemonitor.com where we have daily insights about the financial services industry. And of course, let me remind you about our mortgage banking update which my colleagues in the Mortgage Banking Group put out regularly to keep you abreast of what's going on in that industry. If you have any questions for us or suggestions for our show please feel free to email us at podcasts at ballardspahr.com and stay tuned each Thursday for a great new episode. Thank you all for listening.