An Enforcement-First Approach

— by BRIAN S. LEVY —

Washington's newest mortgage regulator—the Consumer Financial Protection Bureau—often seems more interested in imposing penalties than in providing clear interpretations. What should its role really be?

In just a few years since its creation, the Consumer Financial Protection Bureau (CFPB) has radically transformed the way in which the mortgage and financial services industry is regulated and policed. Already, the CFPB has promulgated several strikingly transformative rules, as well as aggressively wielded its unprecedented punitive powers in the name of consumer protection. ¶ As a result, the leading narrative in the mortgage industry over the past two years has not been market trends, new products or thought leadership. Instead, it has dwelled on answering the question "What does the CFPB think about that?" Or perhaps, "What will the CFPB do next?" ¶ More than just an aggressive posture toward industry, what is unique about this

agency is the way it uses enforcement to articulate and implement new policy objectives on existing regulations.

CFPB in perspective

Created by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, CFPB is the most powerful consumer regulatory and enforcement agency in U.S. history.

Given the perceived role of the residential mortgage industry during the genesis of Dodd-Frank, it is no surprise that mortgage lenders and servicers have been squarely in the crosshairs of CFPB's new enforcers.

CFPB was charged with implementing many Dodd-Frank provisions through formal rulemaking—including the Truth in Lending Act (TILA)–Real Estate Settlement Procedures Act (RESPA) Integrated Disclosure rule (TRID), the Qualified Mortgage (QM) rule and the loan originator compensation rule. The bureau also was given enforcement and interpretative authority over nearly all existing federal consumer financial-related statutes.

Ultimately, offering compliance guidance solely through these "bad actor" consent orders is ineffective.

Through Dodd-Frank, Congress also empowered CFPB with authority to impose massive penalties and strong administrative enforcement mechanisms, including comprehensive abilities to investigate and punish wrongdoing.

In its five-year history, in addition to filling the *Federal Register* with thousands of pages of regulations for the seminal Dodd-Frank mortgage rules of TRID, QM and loan officer compensation, the CFPB has also proven itself a fierce enforcer against perceived consumer financial abuses. The bureau's record to date provides an immediate contrast to past consumer and provider complaints that bad actors in the financial services world would too often escape accountability.

CFPB enforcement as interpretative guidance

Despite laudable enforcement advocacy for consumers, since promulgating the Dodd-Frank-mandated mortgage rules, the CFPB has hindered its regulatory role for the mortgage industry and inspired constitutional challenges to the limits of its power by using enforcement as its primary regulatory tool to provide interpretative guidance.

Ironically, if challenges to its authority are upheld, CFPB's aggressive use of enforcement-focused tactics may ultimately weaken the important consumer-protection role the agency was intended to play.

CFPB's guidance-through-enforcement approach has been challenged as being both substantively and procedurally defective from a constitutional perspective. For a federal government agency to provide interpretative guidance through enforcement, or to blatantly change existing interpretation or regulation, is inconsistent with the constitutionally mandated "notice and opportunity to be heard" principles of due process embedded in administrative law decisions over the past 50 years.

An enforcement action, on the other hand, is immune from due process and transparency because it is necessarily confidential and limited to the facts and circumstances of the defendant investigated. Moreover, settlement of a private disputed matter may not yield generalizable principles—particularly in the case of defendants who are unable to fund the costs of a defense against CFPB's massive penalty regime. For example, Dodd-Frank also gave CFPB the power (which it doesn't seem shy about exercising) to impose penalties equal to $5,000 per day per violation, which rises to $1 million per day per violation for "knowing" violations. These kinds of penalties, assessed on a per day/per violation basis, can quickly add up to a point where the defendants are rarely willing to mount a serious defense due to the potential costs of losing, so a consent order is the only viable alternative.

Ultimately, offering compliance guidance solely through these "bad actor" consent orders is ineffective and hard to generalize, and thus increases confusion for those dedicated to operating in a compliant fashion.

"Setting aside the constitutional questions, guidance through enforcement is like trying to learn how to ski by watching videos of people falling," says Maggie Weir, vice president, assistant general counsel and chief compliance officer at Cambridge, Massachusetts–based Cambridge Savings Bank and adjunct law professor at Boston University.

Mortgage industry feels the impact

In no other area is CFPB's enforcement-based approach to providing interpretations more evident than in the regulation and punishment of the residential mortgage lending business.

Helpful but non-binding Small Entity Compliance Guides were issued in connection with some of the formal rulemaking CFPB has undertaken. Yet, when interpreting and providing guidance on existing rules, CFPB relies on enforcement as the primary means to convey its positions to the mortgage industry.

Prior to the initial effective date, the inflexibility of CFPB to confirm a TRID implementation grace period or to provide formal interpretative TRID guidance to specifically identified issues illustrates the bureau's enforcement-first posture. And CFPB's RESPA Compliance Bulletin 2015-5 offered more stark evidence of CFPB's "punishment" approach to the regulation of the mortgage business.

The TRID implementation experience

In the months leading up to TRID's effective date, the CFPB was unwilling to allow for a formal grace period in the TRID implementation schedule. Only after all of the work had been done to meet CFPB's inflexible deadlines did CFPB seemingly relent in its implementation timing demands, but even then the message from the agency was equivocal.

TRID represented an overhaul of the entire mortgage loan disclosure process, designed to provide better and more timely information in a consistent fashion for consumers. TRID, however, is more than just new disclosure forms. There are new detailed disclosure obligations and inflexible time frames for advance consumer disclosure that must be followed.

Coordination among providers is now more important than ever. Any mistake with the TRID forms, timing or rules could result in significant regulatory penalties and/or consumer class-action damages. The cost to undertake the conversion to comply with TRID has encompassed new technology, new policies, training, testing and implementation. All of this has easily cost the industry millions of dollars, if not billions,

across the board, to become compliant.

Apparently, CFPB recognized TRID's complexity and offered guides and seminars to help with implementation. Those efforts, however, were undermined by the CFPB's unwillingness to stand behind the written and verbal guidance that it provided, leaving industry to take the risk that CFPB's enforcers (or class-action claimants) could reverse course and allege a violation later.

Originally, CFPB set a drop-dead implementation date 18 months out, allowing the industry until Aug. 1, 2015 (later extended to Oct. 3, 2015), to prepare. Due to the massive overhaul of existing systems and processes TRID would entail, however, the mortgage industry and its systems vendors virtually begged CFPB for more time to complete the needed system changes. They asked the bureau to extend a non-enforcement grace period to enable good faith compliance efforts to suffice while initial kinks in the new TRID process were worked out.

Industry trade groups provided CFPB with detailed written letters containing numerous examples of real-life and well-considered concerns with the TRID forms and process that might delay closings or create consumer harm or confusion. Yet, perhaps partially due to high turnover among CFPB staffers responsible for the TRID rules, CFPB failed to provide guidance on most of the noted issues and denied that the new rule would delay closings.

As Oct. 3, 2015, approached, when asked whether formal guidance would ever be provided on these TRID questions, CFPB's "spinworthy" response, offered in a presentation to attendees at the Washington, D.C.–based Real Estate Services Providers Council Inc. (RESPRO®) Regulatory Seminar in September 2015, was that it didn't want to issue guidance so close to the implementation date because it would likely confuse the industry.

Even though an ironic technical error by CFPB in the timely submission of TRID's effective date necessitated an extension to October 2015, CFPB steadfastly refused to offer any flexibility to address the industry's concerns.

Finally, when questioned directly by Congress about this approach, CFPB Director Richard Cordray extended a level of reassurance that CFPB would not be aggressive in its enforcement posture in the early days of the rule. Thereafter, on the eve of TRID's implementation date, CFPB and other regulatory agencies published letters reiterating reassurances as to their early enforcement intentions, but CFPB and the agencies did nothing to address the risk of class-action lawsuits.

Any breathing room, however, seemed short-lived. Two weeks after TRID went live (before virtually any loans had even closed with the new forms), Director Cordray announced at the 2015 Mortgage Bankers Association (MBA) Annual Convention that CFPB was considering regulating systems providers due to CFPB's disappointment in their ability to meet deadlines with compliant systems.

Then, as reported by Kate Berry in *American Banker* on Dec. 8, 2015, Calvin Hagins, the CFPB deputy assistant director for originations, told attendees at a mortgage conference on Dec. 7, 2015 (just two months after TRID's effective date), "There were a number of letters that were written to the regulators, meaning the prudential regulators as well as the CFPB, from a lot of different sources, all asking for a grace period, a hold-harmless period: 'We don't have enough time to comply, please extend it,'" Hagins said. The CFPB heard those calls, but *"no further breaks on enforcement will be given"* (emphasis added), Hagins said.

On Dec. 11, 2015, MBA President and Chief Executive Officer David Stevens sent an email to MBA members in which he highlighted the continued frustration with the lack of TRID guidance forthcoming from CFPB, stating, "We recognize that the current situation is not sustainable, and that further clarity from the CFPB is essential to bring efficiency to the closing process."

Then, in response to a letter from Stevens about TRID-related issues, Cordray wrote to MBA on Dec. 29, 2015, providing assurances about the lack of liability for technical TRID errors and seeming to directly contradict Hagins by reiterating that initial TRID examinations would be corrective, not punitive.

Still, numerous substantive TRID questions remain unresolved.

As noted by Richard Andreano Jr., partner with Ballard Spahr LLP in Washington, D.C., in the firm's Jan. 7, 2016, *Mortgage Banking Update,* "During 2015, despite requests from the industry to address many apparent errors with the TRID rule, the CFPB has so far decided not to act—not even to address issues that would be relatively simple to correct. For example, because of an apparent error, property taxes paid at closing were not included in the list of items that are not subject to a specific percentage tolerance. There also are disclosure issues, such as the provisions for determining how to complete the cash-to-close sections of the Loan Estimate and Closing Disclosure, which, if followed as set forth in the TRID rule, can result in disclosing that there are no closing costs being financed when, in fact, the lender is financing closing costs; and disclosing a cash-to-close amount that is lower than the actual cash needed to close. And there is the so-called black hole issue that appears to prevent a creditor, in various cases, from being able to reset the tolerances with a Closing Disclosure. Perhaps the CFPB will see fit to address the many issues in 2016."

CFPB's reluctance to formally and unequivocally recognize good faith compliance efforts and its failure to provide enforceable guidance to numerous identified concerns about TRID is troubling. Despite any "on again/off again" assurances from Cordray, TRID demands full compliance by its terms—so even if a lender is truly seeking to help the consumer, there is no leeway to bend TRID's requirements.

If TRID were a simple form change, that might make sense. But given that it's an overhaul of the entire loan process from application to closing, and the tremendous efforts of the industry to get ready for TRID, it is baffling why the CFPB would not commit to a formal leniency period, let alone unequivocally honor the one it specifically offered for a reasonable period of time. CFPB's approach to TRID's implementation

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issues suggests an agency focused on maintaining maximum enforcement flexibility rather than on providing leadership through clear guidance.

CFPB's Compliance Bulletin 2015-5

Meanwhile, in another example of how it uses enforcement as guidance, CFPB issued RESPA and MSA Compliance Bulletin 2015-05 on Oct. 9, 2015, noting RESPA risks and issues with marketing services agreements (MSAs).

The bulletin claims to be a summary of MSA-related RESPA enforcement actions, but doesn't define what it views to be an MSA and uses factual situations from RESPA-related consent orders not involving MSAs to articulate the bulletin's MSA guidance.

It also makes a point of saying that it is not binding as an official interpretation; so, in its own words, CFPB diminishes the bulletin's importance. The bulletin, while couched as guidance for the industry, fails to be the kind of rigorous and detailed analysis of fact applied to law and regulation expected from an agency charged with having industry expertise.

Rather than providing clarity, the bulletin actually creates confusion by lumping a set of unrelated business practices held together primarily by the claimed risk of (undefined) MSAs violating RESPA's referral fee prohibitions.

Industry observers should pay close attention to PHH Corporation's appeal of Cordray's decision.

Most settlement service professionals consider an MSA to be an agreement in which one settlement service provider offers and provides various paid marketing and advertising services to another settlement service provider. Using that common understanding (again, CFPB did not define an MSA), there has been only one enforcement action resulting in a publically available decision involving an MSA—the CFPB's consent order issued in connection with Lighthouse Title Inc. in Administrative Proceeding File No. 2014-CFPB-0015.

Yet, under the rubric of providing MSA guidance, the bulletin recounts several other enforcement actions that had nothing to do with the Section 8 (c)(2) (services rendered) kind of RESPA issues raised by MSAs (as defined earlier). These other enforcement actions were related to affiliated business arrangements; unfair, deceptive, or abusive acts or practices (UDAAP); or simple RESPA Section 8 (a) "payment for referral" violations without a "services rendered" exception defense.

Moreover, considering the importance of transparency to due process and fairness, it is equally troubling that in reaching several of the bulletin's conclusions (including an opaque and unexplained admonishment about not entering into MSAs in an effort to establish more MSAs), the CFPB apparently relied on confidential investigations or enforcement actions that are either ongoing or concluded without public enforcement. In other words, there is no way to find out anything about the enforcement actions and investigations the CFPB relied on to issue the bulletin.

Using this kind of confidential enforcement information to provide industry guidance begs the question as to why the CFPB does not also communicate results of investigations that do not result in enforcement action. Presumably, equally important insights about how to legally operate MSAs (or comply with other CFPB-enforced regulations) could be gained from non-public investigations resulting in no enforcement consequences.

The bulletin also clearly relied upon the reasoning in the decision offered by CFPB Director Cordray against PHH Corporation and other defendants in Administrative Proceeding 2014-CFPB-0002 (under appeal to the District of Columbia Circuit Court in case No. USCA 15-1177). In that decision, Cordray articulated CFPB's position that even if one pays reasonable value for a service, Section 8 (c) (2) of RESPA also requires that there be no agreement regarding referrals (and CFPB also contends the burden is on the defendant to prove there isn't such an agreement).

Essentially the bulletin is saying that CFPB doubts a lender can have an MSA based on advertising alone without there also being agreements about referrals.

CFPB's position requiring the absence of any agreements regarding referrals, however, is directly contrary to previous formal official Department of Housing and Urban Development (HUD) interpretations as well as multiple legally binding court decisions on RESPA's Section 8 (c)(2) services rendered exception. MSA participants will no doubt be challenged to produce evidence that an agreement regarding referrals does not exist, because it is extremely difficult to disprove a negative.

The CFPB's future

CFPB appears dedicated to its enforcement-first approach and does not appear dissuaded by the type of criticism noted in this article. With the CFPB bolstered by unwavering support from the person who originally conceived of it—Sen. Elizabeth Warren (D-Massachusetts)—and many of her Senate colleagues, as well as an administration seemingly unwilling to rein in the CFPB (the director has been appointed with a five-year term and cannot be removed except for impeachable offenses), the most likely source of restraint will need to come from the judiciary.

In that regard, industry observers should pay close attention to PHH Corporation's appeal of Cordray's decision.

For the vast majority of financial service providers that want do business legally, the CFPB's unprecedented use of enforcement to provide regulatory guidance is ineffective and frustrating.

The CFPB's strategy is creating unnecessary acrimony with industry and leading to calls for more accountability and broad reform of the CFPB through the legislative or judicial process. To be an effective and sustainable regulatory agency, in addition to punishing wrongdoing, CFPB will need to provide reasoned, clear and constitutionally developed interpretative guidance to those who seek to comply. **MB**

Brian S. Levy is of counsel at Katten & Temple LLP in Chicago, where he provides mortgage banking and financial service regulatory and transactional guidance. He can be reached at blevy@kattentemple.com. Note: The author wishes to thank Brian Rieger and Maggie Weir for their insights and contributions to this article.