

## **The Dodd Frank Act: Important Points for Financial Services Litigators**

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In the wake of America's recent financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law on July 21, 2010. The Act, which was enacted as a measure to promote financial stability, calls for increased regulation of nearly every aspect of the financial industry. Importantly for financial services litigators, Titles X and XIV of the Act open the door for increased litigation by both federal agencies and individual consumers against financial product and service providers.

### **Title X: The Bureau of Consumer Financial Protection**

Title X of the Act creates the Bureau of Consumer Financial Protection (the "CFPB") as an independent Bureau within the Federal Reserve System. Described by President Obama as a "watchdog for the American consumer," the CFPB will act as an advocate for consumers by implementing and enforcing financial law and ensuring that markets for financial products and services are fair, transparent, and accessible.

### **Composition of the Bureau of Consumer Financial Protection**

The CFPB will be headed by a single director appointed to a five-year term with the advice and consent of the Senate.<sup>3</sup> The director will be a member of the Oversight Council with authority over the Bureau, will serve on the Board of Directors of the FDIC, and will be a member of the Federal Financial Institutions Examination Council. To date, President Obama has not yet appointed a director for the CFPB.

Once appointed, the director of the CFPB is required to establish a number of functional units and offices within the bureau. These departments and their respective duties include:

- A Research Unit to "research analyze and report" on consumer finance issues;

- A Community Affairs Unit to provide “information, guidance, and technical assistance” regarding underserved consumers;
- A Complaints Unit to facilitate the centralized collection of, monitoring of, and response to consumer complaints regarding consumer financial products and services;
- An Office of Fair Lending and Equal Opportunity to provide oversight and enforcement of fair lending laws;
- An Office of Financial Education to develop and implement initiatives intended to educate and empower consumers to make better informed financial decisions;
- An Office of Service Member Affairs providing specialized protections for service members and their families; and,
- An Office of Financial Protection for Older Americans designed to facilitate the financial literacy of individuals 62 years of age and older.<sup>4</sup>

The director will also establish a Consumer Advisory Board to advise and consult with the CFPB in the exercise of its functions under the federal consumer financial laws.<sup>5</sup>

### **Functions of the Bureau**

While the CFPB has six primary functions, two of these are especially notable for financial services litigators - the Bureau's supervision and rulemaking functions. The "supervision" function of the CFPB involves (i) supervising "covered persons" for compliance with federal consumer financial laws and (ii) taking appropriate enforcement actions to address any violations. The Dodd-Frank Act defines "covered persons" to include "any person that engages in offering or providing a consumer financial product or service" and such person's affiliates if the affiliate acts as a service provider to the covered person.<sup>6</sup>

Specifically, the CFPB has varying supervisory powers over three main types of financial institutions. With regard to non-depository institutions that offer origination, brokerage, or servicing of mortgages and home equity loans, and larger market participants to be defined by the Federal Trade Commission consulting with the CFPB, the CFPB has supervisory power to require reports and conduct examinations to ensure compliance with federal consumer financial law. As to enforcement actions, however, the CFPB will coordinate with the Federal Trade

Commission.<sup>7</sup> With regard to insured depository institutions or credit unions with total assets of greater than ten billion dollars and their affiliates, the CFPB has exclusive authority to require reports and conduct examinations, as well as primary enforcement authority.<sup>8</sup> Finally, for insured depository institutions or credit unions with total assets of less than ten billion dollars, the CFPB may only require reports as necessary to support its role in implementing federal consumer financial law, and enforcement authority lies with the prudential regulator.<sup>9</sup>

While these three categories place a great number of institutions within the CFPB's scope of power, a number of other institutions are expressly excluded. Institutions and individuals exempt from the CFPB's authority include merchants and retailers of nonfinancial goods and services; real estate brokers and agents; manufactured and modular home retailers; tax preparers; attorneys; auto dealers; employee benefit and compensation plans; persons regulated by state insurance or securities regulators; and persons regulated by the SEC, CFTC, and Farm Credit Administration.<sup>10</sup>

The second notable function of the CFPB is with regard to rulemaking. The CFPB serves the broad function of issuing rules, orders, and guidance to implement federal consumer financial law. In order for the CFPB to take over rulemaking with regard to existing federal laws, several federal authorities will transfer all consumer financial protection functions to the CFPB on the "designated transfer date" of July 21, 2011. These authorities include the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Trade Commission, and the Office of Thrift Supervision.

Furthermore, rulemaking authority over certain "designated laws" will also transfer to the CFPB as of the designated transfer date.<sup>11</sup> These "designated laws" include:

- Alternative Mortgage Transaction Parity Act
- Consumer Leasing Act

- Electronic Fund Transfer Act
- Equal Opportunity Credit Act
- Fair Credit Billing Act
- Fair Credit Reporting Act
- Home Owners Protection Act
- Fair Debt Collection Practices Act
- Home Mortgage Disclosure Act
- Home Ownership and Equity Protection Act
- Real Estate Settlement Procedures Act
- S.A.F.E. Mortgage Licensing Act
- Truth-in-Lending Act
- Truth-in-Savings Act

By virtue of its rulemaking function, the CFPB is vested with the duty and authority to prevent covered persons and financial institutions from engaging in "unfair, deceptive, or abusive" acts or practices in connection with consumer transactions, and to "administer, enforce, and otherwise implement" provisions of federal consumer financial law.<sup>12</sup> With respect to review of any determination of the CFPB regarding the meaning of a provision of federal consumer financial law, courts must afford the CFPB such deference as if the CFPB were the only agency authorized to "apply, enforce, interpret, or administer" the provisions of such law.

### **Restrictions and Authorities**

Subtitle C of Title X sets forth certain restrictions and specific authorities of the CFPB notable to financial services litigators. First, and potentially problematic for financial service providers, the CFPB is authorized to prescribe rules implementing additional disclosure requirements with respect to consumer financial transactions.<sup>13</sup> These requirements may be implemented "to ensure that the features of any consumer financial product or service are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service."<sup>14</sup> However, Section 1032 also provides a safe harbor for providers. The CFPB may issue "model form" disclosures in connection with any rule promulgated by it prescribing additional disclosure

requirements. If a regulated entity uses a model form disclosure in connection with a regulated transaction, that entity “shall be deemed to be in compliance with the disclosure requirements” of the rule.<sup>15</sup>

Specifically notable for mortgage providers, Section 1032 further requires the CFPB to propose within one year after the designated transfer date rules and model disclosures that combine the disclosures required under the Truth in Lending Act and Sections 4 and 5 of the Real Estate Settlement Procedures Act into a single, integrated disclosure for mortgage loan transactions.

Also potentially problematic, Title X sets forth certain broadly prohibited acts that regulated entities and their counsel should note. Under Section 1036, regulated entities may not: (i) offer or provide to any consumer a financial product or service not in conformity with federal consumer financial law; (ii) commit any act or omission in violation of a federal consumer financial law; (iii) engage in any unfair, deceptive, or abusive act or practice; or (iv) fail or refuse, as required by federal consumer financial law or any rule or order issued by the CFPB, to permit access to or copying of records, establish or maintain records, or make reports or provide information to the CFPB.

### **Enforcement Powers**

The CFPB is authorized to conduct investigations to determine whether any regulated entity has engaged in a violation of federal consumer financial law.<sup>16</sup> If the CFPB believes a violation has occurred, it may institute cease and desist proceedings.<sup>17</sup> With the Department of Justice, the CFPB may also bring actions against a violating entity for civil penalties or equitable relief.<sup>18</sup> Such civil actions must be commenced no more than three years after the date of discovery of the violation.

Pursuant to Section 1055 of Title X, the relief available in administrative proceedings or court actions for violations of federal consumer financial law may include:

- Rescission or reformation of contract;
- 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 costs of the notification;
- Limits on the activities or function of the regulated entity; and
- Civil money penalties.

Further, violating entities may be subject to one of three penalties. For any general violation of a law, rule, or final order or condition imposed in writing by the CFPB, a civil penalty may not exceed \$5,000 for each day during which the violation or failure to pay continues. For any person that *recklessly* engages in a violation, a civil penalty may not exceed \$25,000 for each day during which the violation continues. Finally, for any person that *knowingly* violates a federal consumer financial law, a civil penalty may not exceed \$1,000,000 for each day during which the violation continues. Notably, nothing in Section 1055 authorizes the imposition of exemplary or punitive damages.<sup>19</sup>

Also notable, Section 1047 of Title X amends the National Bank Act and the Home Owners' Loan Act to provide that such statutes no longer restrict the authority of a state attorney general to bring suit against a national bank or thrift. Codifying the Supreme Court's decision in *Cuomo v. Clearing House Ass'n, LLC*, 129 S. Ct. 2710 (2009), Section 1047 provides that state attorneys general may bring actions against national banks to enforce applicable law and to seek relief authorized by that law.

### **Changes to Preemption**

Subtitle D of Title X implements significant changes to state law preemption that financial service providers will need to recognize. First, Section 1041 provides greater

protections for consumers under state laws relating to financial services and products, mandating that all state laws considered “inconsistent” with the provisions of Title X will be preempted. However, any state statute, regulation, order, or interpretation is *not* inconsistent with Title X if the protection afforded by it is *greater* than the protection provided by Title X.

Section 1044 of Title X governs state law preemption standards for national banks and their subsidiaries and significantly reduces the ability of national banks and thrifts to rely upon federal preemption of state financial laws. Under Title X, the term “State Consumer Financial Law” means “a State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction . . . or any account related thereto, with respect to a consumer.”<sup>20</sup> While the extent of laws which fall within this definition is unclear, the general preemption standard applying to such laws is clear. Under Title X, state consumer financial laws will be preempted only if (i) application of the law would have a discriminatory effect on national banks; (ii) the law “prevents or significantly interferes with the exercise by a national bank of its powers (in accordance with the legal standard for preemption found in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al.*, 517 U.S. 25 (1996)); or (iii) the law is preempted by another federal law.<sup>21</sup> Determinations regarding the preemption of a state law must be made on a case-by-case basis. Section 1044 defines “case-by-case basis” as referring to a determination made by the OCC concerning the impact of a particular state consumer financial protection law on any national bank or on the law of another state with “substantially equivalent terms.” When making a determination regarding preemption of a law with “substantially equivalent terms” as a law that the OCC is preempting, the Comptroller must first consult with

the CFPB and the views of the bureau must be taken into account when making the determination.

Moreover, the OCC must periodically conduct reviews of each preemption determination. These reviews must take place at least once every five years and the OCC must publish notice in the Federal Register announcing the decision to continue or rescind the determination.<sup>22</sup> Notably, the primary problem with such a system of review is that financial service providers will never know precisely when preemption of any state law is “final.”

Finally, Section 1044(e) of Title X mandates that any state consumer financial law shall also apply to the subsidiaries or affiliates of a national bank (other than a subsidiary or affiliate that is chartered as a national bank), to the same extent as it applies to any person, corporation, or entity subject to such state law. This “subsidiary preemption” provision eliminates the extension of preemption to operating subsidiaries of national banks and thrifts, superseding the U.S. Supreme Court’s decision in *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007).

### **The Mortgage Reform and Anti-Predatory Lending Act**

Title XIV of the Dodd-Frank Act is comprised of the Mortgage Reform and Anti-Predatory Lending Act (the “Mortgage Act”). This Act was developed with the intention of reforming the mortgage lending industry to provide for increased accountability of lenders and increased protection of consumers. It does so largely by amending certain provisions of the Truth in Lending Act (“TILA”) to require increased regulation and to prohibit or restrict lending practices that have been deemed abusive by Congress. Many of the Mortgage Act’s provisions will be included in the “enumerated consumer laws” coming under the purview of the CFPB created by Title X.

### **Mortgage Origination Procedures**

The Mortgage Act creates two new possible causes of action for consumers related to the mortgage origination process: (i) breach of the duty of care by a mortgage originator, and (ii) violation of the prohibition on steering incentives.

Sections 1401 and 1402 of the Mortgage Act amend TILA by broadly defining a "mortgage originator" and subjecting such originators to a delineated duty of care. Under this new two-prong duty of care, mortgage originators must (i) be qualified, registered, and licensed in accordance with applicable state law and the Secure and Fair Enforcement for Mortgage Licensing Act; and (ii) include on all loan documents any unique identifier provided by the Nationwide Mortgage Licensing Systems and Registry. Notably, this duty is prescribed subject to additional regulations to be issued by the CFPB, and consumers will have a private right of action pursuant to Section 1404 against mortgage originators if the duty is violated.

Section 1403 of the Mortgage Act further amends TILA by adding a prohibition on steering incentives for mortgage originators. Generally, in connection with a residential mortgage loan, a mortgage originator is not permitted to receive any compensation from any person that varies based on the terms of the loan, other than the amount of the loan principal. Additionally, for any mortgage loan, a mortgage originator may not receive from any person, *other than the consumer*, any origination fee or charge except bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of either. These prohibitions similarly apply to any person seeking to pay to a mortgage originator any varying compensation or origination fee/charge. However, the prohibition does *not* apply if a mortgage originator receives from a person other than the consumer an originator fee or charge and (i) the mortgage originator does not receive any compensation directly from the consumer, and (ii) the consumer

does not make an upfront payment of discount points, origination points, or fees other than bona fide third party charges.

Pursuant to Section 1404 of the Mortgage Act, consumers will have a private right of action for violations of the prohibition on steering incentives already in place and will also have a cause of action for violations of any additional regulations to be set in place by the CFPB. These actions may be brought against either a lender or mortgage originator. Additionally, consumers may use a violation of the prohibition on steering incentives as a defense to foreclosure. Section 1413 amends TILA to permit a consumer to assert any violation by a creditor of the prohibition on steering incentives as a defense by recoupment or setoff to a foreclosure action. The amount of recoupment or setoff resulting from the assertion of such a violation will be equal to the amount to which the consumer would be entitled if he or she had brought an original action against the creditor, plus the costs to the consumer of the action and a reasonable attorney's fee.<sup>23</sup>

These private rights of action for violations of the duty of care and the prohibition on steering incentives are created by amending the already existing civil liability provisions in TILA Section 130 to similarly apply to mortgage originators.<sup>24</sup> More specifically, Section 1404 states that "for purposes of providing a cause of action for any failure by a mortgage originator" to comply with the Act's new mandates, Section 130 of TILA shall be applied with respect to any such failure by replacing the term "creditor" with "mortgage originator" as it appears in the section. This cause of action under Section 1404 extends not only to acts taken in violation of the immediate mandates of Title XIV, but also to violations of any regulations to be prescribed by the CFPB thereunder.

Further, the maximum amount of liability for a mortgage originator in violation of Title XIV shall not exceed "the greater of actual damages or an amount equal to three times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation, plus the costs to the consumer of the action, including a reasonable attorney's fee."<sup>25</sup> Lenders found in violation of the prohibition of steering incentives may be liable for all interest and fees paid by the borrower as well as actual and statutory damages as set by revised TILA Section 130(a).<sup>26</sup> Finally, Section 1416 sets the statute of limitations for these violations at three years after the date of occurrence of the violation.

#### Minimum Standards for Mortgages

Subtitle B of the Mortgage Act amends TILA to impose new minimum standards for residential mortgage loans and creates for consumers a new cause of action against lenders for failure to determine a borrower's "reasonable ability to pay" prior to entering a loan transaction. Section 1411 provides that no creditor may make a residential mortgage loan until it has made a "reasonable and good faith" determination that the borrower has a "reasonable ability to repay." If a consumer has more than one loan secured by the same property, the lender must make a similar determination that the consumer has a reasonable ability to pay the combined payments of *all* loans secured by the property. For nontraditional loans, including variable rate loans that defer payment of any principal or interest, interest-only, and negative amortization loans, the Mortgage Act sets forth additional specific rules for lenders to follow in determining a consumer's ability to pay.<sup>27</sup>

Violations of Section 1411 will subject lenders to consumer claims pursuant to TILA Section 130(a), as amended by Section 1416 of the Mortgage Act. Though such litigation will be

new on the federal level, similar violations have previously been litigated in some jurisdictions based on state consumer protection laws requiring a determination of reasonable ability to repay as a method of preventing unconscionable loan transactions. Violations of Section 1411 will also constitute a new defense for consumers to foreclosure actions. Pursuant to Section 1413 (amending TILA Section 130), a consumer may assert any violation by a creditor of the "ability to repay" requirement as a defense by recoupment or setoff to a foreclosure action. The amount of recoupment or setoff resulting from the assertion of such a violation will be equal to the amount to which the consumer would be entitled if he or she had brought an original action against the creditor, plus the costs to the consumer of the action and a reasonable attorney's fee.<sup>28</sup>

Importantly, however, the Mortgage Act provides a safe harbor to the "ability to repay" determination required by Section 1411. Under Section 1412, any creditor with respect to a residential mortgage loan may *presume* that the borrower has the required ability to repay *if* the mortgage is a "qualified mortgage." A standard "qualified mortgage" under the Act is any residential mortgage loan for which:

- the regular period payments of the loan may not result in an increase of the principal balance or allow the customer to defer payments of principal,
- the terms do not result in a balloon payment more than twice as large as the average earlier scheduled payments,
- the income and financial sources relied upon to qualify the obligors on the loan are verified and documented,
- for a fixed rate loan, the underwriting process is based on a payment schedule that fully amortizes the loan over its term,
- for an adjustable rate loan, the underwriting is based on the maximum rate permitted under the loan during the first 5 years and the payment schedule fully amortizes the loan over its term,
- the loan complies with any guidelines or regulations established by the Board of Governors in regards to ratios of total monthly debt to income or alternative measures of ability to pay regular expenses after payment of total monthly debt,
- the total points and fees payable in connection with loan do not exceed 3% of the total loan amount, and
- the term of the loan does not exceed 30 years.<sup>29</sup>

Notably, some of these requirements are not necessary or are altered for various special loan forms such as balloon loans and reverse mortgages, and the CFPB has authority to prescribe such additional regulations as it deems necessary. The CFPB may also revise the criteria that define a qualified mortgage upon a finding that such revision is necessary or proper.<sup>30</sup>

### **Increased Liability and New Defenses**

The Mortgage Act also amends TILA Section 130 to increase the amount of civil money penalties for certain violations and to extend the statute of limitations period for a consumer to bring a cause of action against a creditor.<sup>31</sup> Civil liability for actions related to consumer leases is increased pursuant to the Mortgage Act from not less than \$100 and not more than \$1,000 to not less than \$200 and not more than \$2,000. For class actions, the cap for recovery of the class is increased from the lesser of \$500,000 or one per centum of the net worth of the creditor to the lesser of \$1,000,000 or one per centum of the net worth of the creditor. TILA Section 130(e) is amended to extend the statute of limitations for violations of TILA Section 129 from one year to three years.<sup>32</sup> The section also sets a three-year statute of limitations for violations of new TILA Sections 129B and 129C added by the Mortgage Act.<sup>33</sup>

While increasing liability, Title XIV also provides some additional measure of protection for lenders. Section 1417 further amends TILA Section 130 to provide that no creditor shall be liable to an obligor where such obligor or a co-obligor has been convicted of obtaining a residential mortgage loan by *actual fraud*. While this amendment does not provide lenders with any protection against consumers merely misrepresenting information, it will provide a buffer from liability if the consumer is *convicted* of fraud.

### **Mortgage Prohibitions to Watch For**

Section 1414 of the Mortgage Act sets forth a number of new prohibitions related to residential mortgage loans for which lenders should be aware in order to avoid potential liability. First, the Act imposes additional restrictions with respect to prepayment penalties. Residential mortgage loans that are not “qualified mortgages” may not contain terms that require a consumer to pay a prepayment penalty for paying all or part of the principal after the loan is consummated.<sup>34</sup> Qualified mortgages may not contain terms under which a consumer must pay a prepayment penalty in excess of specific limitations set forth by the Mortgage Act. Additionally, creditors may not offer to a consumer any residential mortgage loan that has a prepayment penalty without also offering the consumer a residential mortgage loan product that does not have a penalty as part of its terms.<sup>35</sup>

The Act also amends TILA to add a prohibition on single premium credit insurance. Pursuant to Section 1414, a creditor may not finance, directly or indirectly, (a) any credit insurance, including life, disability, unemployment, or property; (b) any accident insurance, including loss-of-income, life, health; or (c) any payments, directly or indirectly, for any debt cancellation, suspension agreement or contract, in connection with any residential mortgage loan or with any extension of credit under an open-end consumer credit plan secured by the *principal dwelling* of the consumer. However, two exceptions to this prohibition should be noted. First, insurance premiums or debt cancellation/suspension fees calculated and paid in full on a monthly basis are not considered to be financed by the creditor. Next, the prohibition does *not* apply to credit unemployment insurance for which (i) the premiums are reasonable, (ii) the creditor receives no direct or indirect compensation in connection with the premiums, and (iii) the premiums are paid pursuant to another insurance contract and are not paid to an affiliate of the creditor.<sup>36</sup>

It should also be noted that the prohibition extends only to credit insurance and not to premiums for mortgage insurance, and that mortgage originators *may* finance single premium credit insurance in an open-end loan that is *not* secured by a mortgagor's *principal* dwelling. For example, this would be permissible where the loan is secured by a borrower's vacation home.

### **State Attorney General Enforcement**

Pursuant to Section 1422 of the Mortgage Act, the ability of state attorney generals to bring enforcement actions under TILA is expanded to include authority to bring actions for violations of new TILA Sections 129B – 129H. Previously, state attorney generals only had power to bring enforcement actions for violations of TILA Section 129.

### **Mortgage Servicing Changes**

Subtitle E of the Mortgage Act addresses changes to mortgage servicing requirements by amending both TILA and RESPA. With respect to TILA, the Mortgage Act makes the following noteworthy amendments:

- Pursuant to Section 1461, creditors will be required to establish an escrow or impound account for the payment of taxes and insurance in connection with certain first lien mortgage loans;
- Pursuant to Section 1462, creditors must provide disclosure notice to consumers where an escrow or impound account is not established in connection with a consumer credit transaction secured by real property or where a consumer chooses to close such an account;
- Pursuant to Section 1464, a mortgage servicer must credit a payment to a consumer's loan account as of the date of receipt, except when a delay will not result in a charge to the consumer and will not affect the consumer's credit report; and,
- Pursuant to Section 1464, a creditor or servicer must respond to a request for the payoff amount of a home loan within a reasonable time not to exceed 7 days following receipt of a written request for the balance from a borrower or from another party on behalf of the borrower.

Section 1463 of the Mortgage Act amends the Real Estate Settlement Procedures Act to impose stricter penalties, timelines, and other prohibitions on mortgage servicers that will

undoubtedly result in additional litigation. Under the new RESPA provisions, servicers of federally related mortgages are prohibited from:

- Obtaining force-placed hazard insurance unless there is a reasonable basis to believe the borrower has failed to comply with the loan contract's requirement to maintain property insurance;
- Charging fees for responding to valid qualified written requests as they will be defined by regulations to be promulgated by the CFPB;
- Failing to take timely action to respond to a borrower's requests to correct errors relating to allocation of payments, final balances for purposes of paying off a loan, avoiding foreclosure, or other standard servicer's duties;
- Failing to respond to a request from a borrower to provide relevant contact information about the owner or assignee of a loan within 10 business days; and,
- Failing to comply with any other obligation found by the CFPB, by regulation, to be appropriate to carry out the consumer protection purposes of the Act

Violations of any of these prohibitions will subject a mortgage servicer to a claim by the borrower and damages as set forth under Section 6(f)(1) and (3) of RESPA, including actual damages, up to \$2,000 in additional damages, and costs and reasonable attorney's fees incurred in a successful action.<sup>37</sup>

Also, potentially problematic for mortgage servicers is the likelihood of increased litigation resulting from servicer inability to comply with new shortened deadlines imposed by the Mortgage Act. Similar to the tightened response time requirements under the amended TILA provisions previously discussed, the Mortgage Act also amends RESPA to decrease the time available to mortgage servicers for responding to qualified written requests from borrowers.<sup>38</sup> Pursuant to the new amendments, the time for a servicer to provide a written acknowledgement of a request is decreased to five days from receipt rather than the previous twenty days. The time for a servicer to make appropriate corrections in the borrower's account or to conduct an investigation and provide the borrower with written clarification or explanation is decreased from sixty days down to thirty days.<sup>39</sup>

Finally, Section 1463 amends RESPA to impose on mortgage servicers an increased penalty for violations. Specifically, the Mortgage Act increases the amount that individuals may recover in addition to actual damages from \$1,000 to \$2,000 where the borrower can show a pattern of noncompliance. The amount that borrowers in a class action are entitled to receive in addition to actual damages is similarly increased from \$1,000 to \$2,000 per member of the class where there is a pattern of noncompliance, and the total recovery for a class is capped at the lesser of 1 percent of the net worth of the servicer or \$1,000,000, rather than \$500,000.

### **Changes regarding Appraisal Procedures**

Title XIV further addresses appraisal issues in relation to residential mortgage loans and subjects creditors to potential liability for failure to obtain a proper appraisal and for interfering with appraiser independence. First, Section 1471 amends TILA to add a new Section 129H and imposes strict appraisal requirements on lenders. Under the new provision, a creditor may not extend credit in the form of a high-risk mortgage to any consumer without first obtaining a written appraisal of the property that complies with certain stated requirements. These appraisal requirements include (i) a physical property visit of the interior of the mortgaged property by a certified or licensed appraiser, and (ii) a second appraisal from a different certified appraiser if the purpose of a higher-risk mortgage is to finance the purchase property from a person within 180 days of that person's purchase of the property at a price lower than its current selling price. This second appraisal should analyze the difference in sale prices, changes in market conditions, and any improvements to the property.<sup>40</sup>

Additionally, creditors should provide a copy of each appraisal conducted in connection with a higher-risk mortgage to an applicant without charge at least three days prior to the

transaction closing date. Willful failure to obtain a proper appraisal will result in a creditor being held liable to an applicant or borrower for the sum of \$2,000, in addition to any other liability.<sup>41</sup>

With respect to appraiser independence, Section 1472 amends TILA to make it unlawful for a creditor providing services for a consumer credit transaction secured by the consumer's principal dwelling to engage in any act that violates appraiser independence. For purposes of the prohibition, acts or practices that violate appraiser independence include:

- any appraisal conducted in which a person with an interest in the underlying consumer credit transaction compensates, coerces, extorts, colludes, instructs, induces, bribes, or intimidates a person, appraisal management company, for or other entity for the purpose of causing the appraisal to be based on any factor other than the independent judgment of the appraiser;
- mischaracterizing or suborning any mischaracterization of the appraised value of the property securing the extension of credit;
- seeking to influence an appraiser to encourage a targeted value for the property to facilitate the making or pricing of a transaction; and
- withholding or threatening to withhold payment for an appraisal where the appraisal is provided for in the contract between the parties.<sup>42</sup>

However, the CFPB and other federal banking agencies are authorized under the new TILA section to jointly issue rules and interpretive guidelines clarifying what acts or practices will violate appraisal independence.

It should also be noted that if a creditor knows, at or before a loan consummation, that a violation of appraiser independence has occurred, that creditor shall not extend credit based on the appraisal unless it first documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate the value of the property. However, nothing in Title XIV prohibits lenders and other parties from asking an appraiser to consider additional properties, provide further detail or explanation of his or her conclusions, or to correct errors in an appraisal report.

Any person found to have violated appraiser independence shall be subject to civil liability as described in TILA Section 130 as well as additional statutory penalties. For a first violation, a violator shall forfeit and pay a civil penalty of not more than \$10,000 for each day such violation continues. For any subsequent violations, a violator shall forfeit and pay a civil penalty of not more than \$20,000 for each day such violation continues.<sup>43</sup>

### **Regulatory Authority of the CFPB and the "Abusive" Standard**

Title X of the Dodd-Frank Act vests in the CFPB broad authority to prevent regulated entities from engaging in unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. For an act or practice to be unfair, it must be likely to "cause substantial injury to consumers not reasonably avoidable by consumers" and the injury must not be "outweighed by countervailing benefits to consumers or to competition."<sup>44</sup> Alternatively, for an act or practice to be abusive, it must be likely to "materially interfere with the ability of a consumer to understand a term or condition of a consumer financial product or service;" or "take unreasonable advantage of (i) the lack of understanding on the part of a consumer of the material risks, costs, or conditions of the product or service; (ii) the inability of a consumer to protect his/her interests in selecting or using a consumer financial services product or service; or (iii) the reasonable reliance by a consumer on a regulated entity to act in the interests of the consumer."<sup>45</sup>

Similarly, Title XIV prescribes the CFPB with discretionary regulatory authority to prohibit or condition terms, acts, or practices relating to residential mortgage loans that the CFPB finds to be abusive, unfair, deceptive, or predatory.<sup>46</sup> Title XIV touches on what acts or practices may be considered "abusive" by mandating that the CFPB prescribe regulations prohibiting

"[a]busive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, gender, or age."<sup>47</sup>

This authority of the CFPB creates a potential for future litigation regarding how the above terms will be interpreted during enforcement actions. While the FTC has previously defined “unfair” and deceptive,” there exists no previous authority regarding an interpretation of “abusive practices.” The definition of “abusive” asserted in Title X turns on a consumer’s knowledge and understanding regarding a consumer financial transaction. This, in addition to the requirement found in Title XIV requiring mortgage lenders to ensure that borrowers have a “reasonable ability to repay” any mortgage prior to making a loan, appears to indicate an intent on behalf of the drafters of the Dodd-Frank Act to require that financial service providers make certain of a consumer’s understanding before completing a transaction. Even with these definitions, however, it is still unclear just what the CFPB will consider “abusive.” While further regulation after the transfer date will likely give some additional clarification, it is equally likely that litigation over the exact meaning of this ambiguous term will be abundant.

### **Pre-Dispute Arbitration Agreements**

Both Title X and Title XIV of the Dodd-Frank Act contain important changes regarding the use of pre-dispute arbitration agreements by financial product and service providers.

Title X requires the CFPB to conduct a study concerning the use of pre-dispute arbitration agreement in relation to consumer financial product and service transactions between covered persons and consumers.<sup>48</sup> Once the study is completed, the CFPB has authority to either prohibit or impose limitations on the use of such agreements in the public interest for the protection of consumers. However, the Bureau may not prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person *after* a dispute has arisen.<sup>49</sup>

Title XIV, on the other hand, imposes an immediate prohibition on pre-dispute arbitration agreements with regard to residential mortgage loan transactions.<sup>50</sup> Under Title XIV, no residential mortgage loan and no extension of credit under an open end plan secured by a consumer's principal dwelling may include terms that require arbitration or any other non-judicial procedure as the method for resolving a controversy or settling a claim arising out of the transaction. Such transactions are also prohibited from containing any waiver of a consumer's statutory right to bring a cause of action in an appropriate court pursuant to TILA Section 130 or any other law. However, consumers and lenders are still permitted to agree to arbitration *after* a dispute has arisen.<sup>51</sup>

### **Conclusion**

The Dodd-Frank Act imposes a number of notable changes and additional restrictions that financial service providers and litigators must prepare for. With its expansive grant of power, the Bureau of Consumer Financial Protection is sure to have a significant impact on the way the consumer financial industry works as a whole. The increased regulation imposed by the Mortgage Act will also greatly impact the consumer financial industry and will likely lead to an abundance of litigation as mortgage originators, lenders, and servicers alike try to adjust to the new requirements. As this occurs, knowledge of the Act's requirements is sure to be vital in defending the interests of financial services clients.

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<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 1011 (2010).

<sup>4</sup> Act § 1013.

<sup>5</sup> Act § 1014.

<sup>6</sup> Act § 1002(6).

<sup>7</sup> Act § 1024.

<sup>8</sup> Act § 1025.

<sup>9</sup> Act § 1026.

<sup>10</sup> *See* Act § 1027 - 29.

<sup>11</sup> Act §§ 1002, 1022.

<sup>12</sup> Act § 1031.

<sup>13</sup> Act § 1032.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

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<sup>16</sup> Act § 1052.

<sup>17</sup> Act § 1053.

<sup>18</sup> Act § 1054.

<sup>19</sup> Act § 1055.

<sup>20</sup> Act § 1044.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> Act § 1413.

<sup>24</sup> Act § 1404.

<sup>25</sup> Act § 1404.

<sup>26</sup> *Id.*

<sup>27</sup> Act § 1411.

<sup>28</sup> Act § 1413.

<sup>29</sup> Act § 1412.

<sup>30</sup> *Id.*

<sup>31</sup> Act § 1416.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> Act § 1414.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> Act § 1463.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> Act § 1471.

<sup>41</sup> *Id.*

<sup>42</sup> Act § 1472.

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<sup>43</sup> *Id.*

<sup>44</sup> Act § 1031.

<sup>45</sup> *Id.*

<sup>46</sup> Act § 1405.

<sup>47</sup> Act § 1403.

<sup>48</sup> Act § 1028.

<sup>49</sup> *Id.*

<sup>50</sup> Act § 1414.

<sup>51</sup> *Id.*