Breaking Down Financial Reform

A Summary of the Major Consumer Protection Portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act

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On July 21, 2010, after cliff-hanging deliberations in the Senate, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "The Act").[1] The massive, far-reaching, and complex new law—15 separate titles in all—was hailed by supporters as "landmark," and the "strongest consumer financial reform since deposit insurance." [2] The National Consumer Law Center promised:

> We will know what we are getting, we will have full competition, the ability to shop around and compare terms that we understand, and won't have unfair tricks and traps.[3]

As they have with previous consumer reforms, critics warned that the law will constrict consumer choice and access to credit and other financial services and drive up fees.[4]

While both sides may be right, it is hard to lament restrictions on consumers' ability to take out loans they do not understand and cannot afford or on lenders' ability to circumvent reasonable lending standards. The loan products and standards that proliferated during the financial bubble – in which lenders provided mortgages without any proof of a borrowers' incomes or assets or offered subprime teaser-rate mortgages whose payments would double (or more) after an initial period – represent no loss to consumers or the financial marketplace. At the same time, it is crucial to ensure that consumers have access to affordable credit. Finding the middle ground—ensuring broad, responsible, honest, and fair access to credit—will be the job for regulators in the years ahead.

This article summarizes the major consumer protection provisions of the Dodd-Frank Act. It does not cover the also significant provisions that aim to address systemic risks, corporate governance and investor protection, too-big-to-fail institutions, hedge funds and derivatives, and restrictions on proprietary trading – to name some of its most important elements. Nor does this article attempt an economic analysis of the law's costs and benefits, which is not only beyond the scope of this article but also would be premature.

It also should be noted that a post-mortem of the legislation is not yet possible. Many provisions of the Dodd-Frank Act require regulatory action to implement. The Act requires approximately 243 rulemakings and 67 studies. The primary thrust of the Act is to create a new regulatory infrastructure, one where the deck is no longer stacked against consumers. But, with few exceptions, the content of the rules will be written over the next few years. As a result, the true scope and impact of the law will not be known for some time, and cannot yet be fairly written.

I. **Structural Changes in Consumer Enforcement**

The Dodd-Frank Act creates both substantive and structural changes in the regulation and enforcement of financial consumer protections. The structural changes are extremely significant, as they set up an ongoing, adaptive mechanism to address and, hopefully, prevent financial consumer fraud. Chief among these changes is the creation of the Consumer Financial Protection Bureau, a new federal agency with substantial authority and a mandate to focus on consumer protection. The law also consolidates rule-writing for, and for the most part enforcement of, consumer protection laws, previously scattered among multiple agencies, in the CFPB, aiming to ensure that the buck – almost literally – stops there. For the first time, a single agency will largely have the authority, responsibility, and knowledge to regulate the broad range of consumer-facing financial services and providers.

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A. Consumer Financial Protection Bureau

The creation of the Consumer Financial Protection Bureau ("CFPB"), Title X of the Act, was hotly fought by financial institutions and represents the biggest win for consumers. Whether the CFPB is vital and powerful will depend largely on its leadership, who will write its first rules and establish its turf, culture, and relationships with other agencies and regulated entities. And, as public attention and outcry over Wall Street practices undoubtedly diminish in the months ahead, financial institution lobbyists will remain fully engaged. They may still be able to shape and constrain the Bureau, even before it takes the stage.

Regardless, the Bureau's creation is an important step forward. It represents a recognition, for the first time, that mortgages and credit cards can be as destructive – both to consumers and the economy – as cars and cribs. Just as with those potentially dangerous products, consumers need to be protected and educated. It also ensures that consumer protection will not continue to take second billing to regulators' focus on financial institution safety and soundness. The failure of all of the relevant federal regulators – the Federal Reserve, the Office of the Comptroller of Currency, and the Office of Thrift Supervision – to have engaged in any real enforcement over the last decade is a function, in part, of their failure to duly value their consumer protection mandate.

More than 400 pages of legislation detail the duties and powers of the Bureau. The Bureau is charged with the responsibility to: "seek to implement and, where applicable, enforce federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[5] The CFPB will be able to issue rules, orders or guidance with respect to any person who offers or provides a "consumer financial product or service."[6] It can conduct hearings, subpoena testimony and documents, and pursue civil enforcement actions.[7] The Act transfers to the CFPB all of the consumer protection functions of the Federal Reserve Board of Governors ("Federal Reserve"), the Office of the Comptroller of Currency ("OCC"), the Office of Thrift Supervision ("OTS"), the Federal Deposit Insurance Corporation ("FDIC"), and National Credit Union Administration ("NCUA"), as well as many of the Department of Housing and Urban Development's ("HUD") consumer protection functions. The CFPB will be responsible for consumer protections under a veritable alphabet soup of federal laws that govern consumer financial services – a total of 17 enumerated federal consumer protection statutes[8] in addition to its "organic" statute, the Dodd-Frank Act. Together, these changes will put the CFPB in the driver's seat as the dominant regulator in this arena.

Through its subject-matter focus on consumer financial products and ser-

vices, the Dodd-Frank Act dissolves a regulatory approach that was driven by the type of institution to be overseen, with different regulators and standards for national banks, thrifts and savings & loans, bank holding companies, and non-bank financial institutions. Financial institutions engaged in precisely the same kinds of consumer services reported to different federal agencies and were often held to different standards of enforcement, and sometimes even different rules. As a result, it was far less likely that any single regulator, looking only at its part of the elephant, would understand the types and impacts of the financial products, services, and marketing reaching consumers. The CFPB's rulemaking authority, more logically, arises from the activities of the subject institutions. Its authority extends to banks, mortgage lenders, brokers, and servicers, credit card issuers, debt collectors, financial advisors, remittance companies, student lenders, check cashers, and payday lenders who provide financial products and services to consumers.[9]

The Dodd-Frank Act delegates three types of authority to the CFPB: rulemaking, enforcement, and supervision. In addition, the Act delineates three types of regulated bodies: large insured depository institutions,[10] smaller insured depository institutions,[11] and non-depository institutions.[12] The sections below explain each type of authority, and with respect to what institutions each type of authority may be exercised.

i. Rulemaking Authority

The CFPB maintains exclusive, independent, and general rulemaking authority, pursuant to both the Dodd-Frank Act and existing federal consumer financial laws, with respect to any financial institution so long as it is offering a "consumer financial product" or service.[13] In prescribing rules, the CFPB is required to take into account the costs and benefits to both consumers and financial institutions covered under the Act. In addition, the Dodd-Frank Act gives the CFPB federal rulemaking authority to draft regulations to prevent unfair,[14] deceptive or abusive practices by banks.[15] The Federal Trade Commission Act ("FTC Act") had previously vested authority in the Federal Reserve, OTS and NCUA to set rules with respect to unfair and deceptive practices of banks, thrifts, and credit unions, respectively.[16] The Act also adds to existing prohibitions on unfair and deceptive acts and practices, a bar on "abusive" practices.[17] It is unclear precisely what this third prong will add, though its seems to both permit and encourage regulators to focus on the victims of financial fraud – allowing action against practices that target specific groups, such as the elderly and non-English speakers, for example, who are particularly vulnerable to financial scams. Furthermore, the "abusive" prong seems to borrow from the concept of unconscionability and as such does not contain the same cost-benefit balancing as "unfairness," giving regulators more leeway in writing rules.

The Bureau's independence in its rulemaking is not unqualified. The Bureau must coordinate its rulemaking (and supervision) with other federal and state regulators to avoid duplicative oversight and inconsistent standards.[18] But the requirement of consultation is not a veto power; no single regulator has the authority to prevent the Bureau from issuing a rule.[19] However, a two-thirds majority of the Financial Stability Oversight Council ("FSOC"), a council of regulators created by the Dodd-Frank Act,[20] can set aside a CFPB regulation on a finding that the rule would jeopardize the safety and soundness of the banking system or the stability of the financial sector. Act §1023(c)(3)(A). This should present a high bar for overruling the Bureau, though it remains to be seen how vigorously the FSOC will attempt to manage the Bureau's rulemaking.

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ii. Supervision and Enforcement

As for supervision, the CFPB's authority is more limited. Under section 1025 its supervisory power entails the ongoing, routine examinations of covered entities and persons to monitor for risks to consumers and markets and to ensure compliance with the law. The Act reintroduces a regulated-entity approach to oversight. With respect to large depositories, the CFPB has exclusive supervisory authority to ensure compliance with consumer financial laws. The CFPB maintains full supervisory authority over non-depositories as well.[21] Its supervisory authority over small depositories, however, is more limited; the CFPB can only require reports from such institutions, accompany the prudential regulator when it is conducting compliance examinations, and refer suspected violations to other agencies.[22] The smaller depositories' relevant prudential (or safety and soundness) regulator maintains exclusive supervisory authority with regard to federal consumer financial law.

The CFPB's primary enforcement authority also extends to large depository institutions, but its authority is limited with respect to small depositories and credit unions.[23] Under section 1042, state attorneys general retain enforcement authority against both, though in the context of national banks and thrifts, their authority is limited to enforcing CFPB regulations and does not extend to the Act's general ban on unfair, deceptive, and abusive practices. (See more on state enforcement under preemption, *infra*.) As for non-depositories, the CFPB was delegated enforcement authority, but it must work out an agreement on exercising its authority with the FTC because the FTC retains concurrent jurisdiction over such entities.

Within these broad areas, the Bureau's divisions, as laid out by the law, provide hints of its intended areas of focus. As would be expected, the CFPB will include research and complaint[24] units, which will provide a deeper understanding of the enforcement and regulatory issues to be addressed. It also includes an Office of Fair Lending and Equal Opportunity, Act §1013(c), Office of Service Member Affairs, Act §1013(e), and Office of Financial Protection for Older Americans, Act §1013(g). As with the introduction of the term "abusive" as a prohibited financial practice, these divisions reveal a constituency-based approach to consumer protection focused not just on the particular products and conduct to be regulated, but also on groups most likely to fall victim to financial fraud. An Office of Financial Education will work to increase consumers' financial literacy (though even the best-armed consumer stands little chance against long, highly technical disclosures or a dishonest broker). Act §1013(d). The Dodd-Frank Act creates an ombudsman focusing on private student loans. Act §1035. The BCFP also must conduct a study of, and provide a report to Congress concerning, the use of mandatory pre-dispute arbitration in consumer financial services. The Bureau then has the authority, by rulemaking, to "prohibit or impose conditions or limitations on the use of" mandatory arbitration clauses, consistent with the study." Act § 1028.[25]

Although it is part of the Federal Reserve, the CFPB has been billed as an independent agency. The Dodd-Frank Act provides the CFPB with several tools to protect its authority, autonomy, and integrity. The Director will be appointed by the President for a five-year term and confirmed by Sen-

ate, Act and the Bureau will have its own dedicated budget, Act §§1011(b)(2) & (c)(2) and §1017(a)(1). Also, the Act explicitly prohibits the Federal Reserve from interfering with any rulemaking, examination, or enforcement action by the Bureau, appointing or removing any of its employees, or merging or consolidating any of its powers within the Federal Reserve.[26] Finally, CFPB legislative recommendations are not subject to review by the Federal Reserve or Office of Management and Budget. Act §1012(c)(3). And, while its location within the Federal Reserve was not consumer advocates' first choice, there may prove to be advantages to housing the Bureau within the regulator with the greatest political and economic clout. As a separate agency, the CFPB could have found itself without a real seat at the table when the rules of the financial road are decided.

B. Consolidation of Regulatory Oversight

Virtually any change in the banking regulatory regime would have to be an improvement over the status quo. Structurally, the Dodd-Frank Act did not go as far as many would have liked, remaining silent, for example, on the roles and duties of the government sponsored enterprises Fannie Mae and Freddie Mac.[27] Despite this fact, as laid out in the previous section, the consolidation of federal enforcement and rulemaking authority under the CFPB represents a tremendous step forward for consumers as it ensures that one player in the system has an understanding of, authority over, and commitment to consumer financial protection.

The Dodd-Frank Act's dissolution of the OTS, which must wind-down within a year, is another worthwhile step. As commentators have noted, competition between the OTS and OCC in oversight of the banks led not to higher standards, but a perilous regulatory race to the bottom. This phenomenon arises from two related flaws in the system: (1) OTS and OCC were largely dependent for their budgets on fees from the banks they examined; and (2) banks could choose their regulator. Banks were able to migrate to the laxest enforcer, and the financial consequences of that choice incentivized the agencies to have the lowest standards.[28]

Unfortunately, the Dodd-Frank Act still leaves a confusing fragmentation of regulators and regulatory functions. OTS's duties will pass to OCC, which will have oversight of federal thrifts and rulemaking authority for all thrifts with respect to laws outside the federal consumer financial arena.[29] (The CFPB, recall, has rulemaking authority with respect to unfair, deceptive and abusive practices and with respect to existing consumer financial laws.) The Federal Reserve will oversee thrift holding companies and thrifts' non-bank subsidiaries engaged in banking activities, such as mortgage lending. Small depositories will have to obey CFPB rules, but are subject to enforcement only by current regulators. Act §1026(a), (d). The FTC retains its existing rulemaking authority with respect to unfair or deceptive acts or practices (or UDAP) under the FTC Act.[30] The CFPB, will also have authority to enforce (against persons within its jurisdiction) rules previously passed by the FTC that relate to unfair or deceptive acts or practices. Act §1061(b)(5)(B)(ii). Additionally, the FTC will be able to enforce UDAP rules passed by the CFPB for entities within its jurisdiction. Act §1061(b)(5)(C). To deal with this overlapping authority, the Act mandates that the FTC and CFPB negotiate an agreement to avoid duplication or conflict. Act §1061(b)(5)(D). As noted above, the CFPB has primary enforcement authority over large depositories, while the OCC, FDIC, Fed Reserve, and NCUA now have backup enforcement authority, i.e. they can enforce where the CFPB fails to bring an enforcement action against a large bank within 120 days of a referral. Act §1025(c).

The CFPB's Office of Fair Lending and Equal Opportunity will also have new powers with regard to fair lending. Act §1013(c)(1). The Office has the power to "provid[e] oversight and enforcement of Federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit for both individuals and communities that are enforced by the Bureau …" Act §1013(2)(A). The Civil Rights Division of the Department of Justice, as well as the FTC and HUD, now will have jurisdiction on fair lending enforcement, leading to a potentially confusing and disjointed enforcement regime. Depending upon the policies of any given administration, this either could lead to a potentially confusing and disjoined enforcement regime, or to one made stronger by the coordinated efforts of specialized agencies, work

ing together at the intersection of consumer protections and civil rights. Finally, the CFPB is required to coordinate its fair lending efforts with federal agencies and state regulators "to promote consistent, efficient, and effective enforcement of Federal fair lending laws." Act §1013(c)(2)(B).

C. Effective Date

As noted above, the Dodd-Frank Act, and the Consumer Financial Protection Act creating the CFPB, were enacted on July 21, 2010. Generally speaking, the CFPB was created upon enactment. However, many of its consumer protection powers do not take effect until the "designated transfer date." Under section 1062 the Act, the designated transfer date is to be set by the Treasury Secretary, in consultation with various federal agencies, within 60 days of enactment, i.e. by September 21, 2010. The designated transfer date may not be earlier than six months or later than one year after enactment, and notice of the transfer date must be published by the Treasury Secretary in the Federal Register. There are certain circumstances under which the Treasury Secretary can extend the designated transfer date beyond one year,[31] but under no circumstances can it be extended beyond 18 months after enactment. Act §1062(c)(3).

II. **New Substantive Consumer Protection Requirements**

In addition to the structural changes put in place by the Dodd-Frank Act, the new law creates new prohibitions and standards for various consumer financial products, most notably, mortgage loans and, to a much more limited extent, credit and debit cards. Many of these changes took effect upon enactment, but, as with other provisions, some rules have to be further fleshed out through rulemaking.[32] Part A of this section lays out the major changes for the mortgage lending market. Part B addresses changes to credit and debit card transactions. Part C briefly covers the Act's changes to federal fair lending laws.

A. Mortgages

The Mortgage Reform and Anti-Predatory Lending Act at Title XIV of the Dodd-Frank Act substantially revises the Truth In Lending Act ("TILA"). As a response to the toxic products and predatory practices of the last decade, this title establishes a number of new standards for the mortgage marketplace.

Title XIV is a web of intertwined loan categories, requirements, and prohibitions. These rules cover mortgage origination and servicing practices and strengthen the remedies available when lenders break the rules. Some of the law's provisions apply to any loan secured by the consumer's principal dwelling, including for the first time, open end credit, and others only apply to "residential mortgage loans." The law also implements new loan categories based on risk characteristics and pricing. Some restrictions apply to all loans, from the safest to the riskiest and most expensive, while others affect only risky and higher-cost loans. Title XIV employs a new concept of "qualified mortgages."[33] These are mortgages whose safe underwriting practices, lower fees, and absence of risky features make them sufficiently reliable to afford them certain privileges, including a rebuttable presumption that a borrower has the ability to repay a loan on the terms that were offered. Title XIV's overall approach reflects an understanding that some lending practices are so harmful to consumers that they should be banned from all mortgages, while in other circumstances, it makes more sense to incentivize lenders to make loans in a fair and responsible fashion. Parts 1, 2, and 3 of this section describe amendments to TILA proper—the part of TILA that governs most mortgage lending—and Real Estate Settlement Procedures Act ("RESPA"), the federal law governing mortgage servicing. Part 4 of this section describes amendments to Home Ownership and Equity Protection Act ("HOEPA"), the part of TILA that specifically governs "high-cost" mortgages. Finally, Part 5 discusses the CFPB's specific authority to make rules with respect to mortgage lending

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1. General Mortgage Lending Rules and Prohibitions

a. *Prohibits steering incentives and yield spread premiums*

For any residential mortgage loan,[34] no mortgage originator[35] is permitted to receive from any person, directly or indirectly, compensation that varies based on the terms of the loan (except for the principal amount of the loan). This definition is aimed at yield spread premiums ("YSPs"), payments made by a lender to a mortgage broker upon origination for placing the borrower in a loan with riskier terms (such as prepayment penalties) or a higher interest rate than the minimum rate required by the lender. YSPs created an inherent conflict of interest between brokers and consumers by providing a financial incentive for brokers to place borrowers into more expensive, and oftentimes more risky, mortgages.[36] Under the Act, brokers (or any mortgage originator) are not permitted to receive YSPs (and lenders are not permitted to pay them) in residential mortgage loans, with one exception; YSPs are permissible as long as the mortgage originator does not receive any compensation directly from the consumer and the consumer does not make any upfront payment of discount points, origination points, or fees other than bona fide third party charges.[37] Act §1403.[38] A mortgage originator's liability for violating this section is not to exceed the greater of either actual damages or three times the total amount of compensation received by the originator, plus costs and reasonable attorney's fees. Act §1404.

b. *"Qualified mortgages."*

As mentioned above, the Dodd-Frank Act creates a new class of "qualified mortgages" that are viewed as sufficiently safe and fair to allow safe harbor from some of the prohibitions and restrictions imposed by the Act. Essentially, the law aims to encourage lenders to move to these more "plain vanilla" mortgages by freeing them from many regulatory hurdles when they make risky loans.

While there are a few specialized carve-outs, for the most part, qualified mortgages meet the following criteria: (1) the regular and periodic payments do not result in negative amortization -- an increase in the principal balance -- or allow the consumer to defer payments, (2) there are no balloon payments, (3) the income and financial resources relied upon in qualifying the borrower are verified and documented, (4) there was reliable underwriting for affordability -- for fixed and adjustable rate loans, underwriting is based on fully amortized payment schedule including taxes and insurance, and for adjustable rate loans, underwriting is based on the maximum rate permitted in the first five years, (5) there was compliance with expected CFPB regulations with respect to debt-to-income ratios or other indicators of the consumer's ability to repay, and (6) the total points and fees do not exceed 3% of the loan's principal. Act §1412.

In the case of prepayment penalties, as detailed below, qualified mortgages must also have annual percentage rates ("APRs") that are less than 1.5 points above a new federal benchmark—the average prime offer rate[39] ("APOR")—for conforming first liens and meet other pricing standards for jumbo and subordinate mortgages.[40]

c. *Requires lenders to ensure borrowers have the ability to repay the loan over its full term, including the requirement to verify borrowers' income*

While this seems to be common sense, in the absence of a requirement that lenders assess a borrower's repayment ability, lenders regularly made loans with exploding payments that borrowers could never afford. By qualifying borrowers at the initial or teaser payment rate, lenders were able to underwrite loans that should never have been made, knowing that they could unload these loans on the secondary market.[41] Moreover, during the housing boom, lenders routinely offered mortgages that required little or no documentation, allowing borrowers eager to participate in the housing boom—and mortgage brokers eager for higher commissions—to exaggerate their qualifications. In the height of the housing boom in 2006 and 2007, low-doc loans accounted for roughly 40% of newly issued mortgages.[42] For even riskier subprime loans, stated income loans may have exceeded 50%.[43] Evidence also suggests that some banks were more than willing to accept or help create these falsified loan applications.[44]

The Mortgage Reform Act expressly prohibits a creditor from making residential mortgage loans unless the creditor makes a good faith determination, based on verified and documented information, that at the time the loan was made the consumer had a reasonable ability to repay the loan (including all fees and taxes).[45] Act §1411. The ability to repay standard is rigorous, and requires lenders to make the evaluation based on a fully amortized payment schedule. Special rules apply for "nonstandard" loans. For example, in determining a borrower's ability to repay a loan with negative amortization, a lender must take into consideration the resulting principal increase. At the bottom line, lenders must ensure that borrowers can afford the monthly payments on their loan for a significant period of time without refinancing out of it.

In an effort to shield legitimate lenders making non-abusive loans from the burden of ensuring the borrower's ability to repay, the law includes a rebuttable presumption that borrowers have an ability to pay their "qualified mortgages." Act §1412. Thus, lenders can trigger the presumption provided they avoid the harmful features that characterized subprime loans leading up to the subprime crisis and instead opt for loan terms that are responsible and fair.

d. Bans prepayment penalties for adjustable rate and higher cost mortgages that are not qualified mortgages

Prepayment penalties were prevalent in the subprime market leading up to the housing crisis, and were present in over 80% of subprime loans.[46] These penalties, which were charged for repaying the loan in the first three to five years, were typically imposed to ensure the lender would recoup the money it paid to mortgage brokers in the form of YSPs. By stripping equity, prepayment penalties made refinancing unaffordable for many borrowers, locking them into high-cost loans and preventing them from refinancing even when their rates or payments reset upwards.

The Dodd-Frank Act bans prepayment penalties in mortgages that are not qualified mortgages under section 1412 of the Act, and for all loans with adjustable rates. Not only that, but the Act restricts prepayment penalties by price and length even for fixed rate qualified mortgages.[47] Act §1414. Finally, a lender may not offer a fixed rate qualified loan with a prepayment penalty without also offering the borrower a loan without a prepayment penalty. Act §1432.

e. Requires disclosure of maximum payment, negative amortization, and loss of anti-deficiency rights

Some of the more complex mortgage products offered in recent years featured teaser or initial low payment rates, which then adjusted upward – often dramatically – after the introductory period. Sold on the low starting payment, many consumers were surprised by and unable to cope with the higher long-term payment. Now, under section 1418, lenders must provide a good faith estimate of the amount the monthly payment will be after it adjusts or resets.

Origination of payment option adjustable rate mortgages, or payment option ARMs, also boomed during the housing bubble. These loans offered borrowers the option of making a minimum payment that did not cover the full principal and interest owed. This payment option resulted in negative amortization, or an increase in the principal balance of the loan during the repayment period. After a period of years or upon hitting a negative amortization trigger, payment options ARMs recast, requiring the borrower to make a dramatically bigger, fully amortizing payment. Whether because the product was unsuitable for, misunderstood by, or misrepresented to consumers, many have been unable to make the higher payment. Under the Dodd-Frank Act, any loan secured by a dwelling or property that includes a dwelling (other than a reverse mortgage) that permits negative amortization must be accompanied by a disclosure stating that: (1) the pending transaction could result in negative amortization, (2) negative amortization increases the principal balance on the loan, and (3) negative amortization decreases the consumer's equity in their property. Act §1414. If the borrower is a first-time borrower, the borrower must provide the lender with documentation showing that borrower completed homeownership counseling.

Established by state law, anti-deficiency rights provide that consumers are not obligated to make up the difference between the price of a foreclosure sale and the outstanding balance on the mortgage. Under section 1414(b), lenders must disclose the loss of anti-deficiency rights, and the significance of this loss, in any refinancing that surrenders this protection.

f. Bans single premium credit insurance for all loans

Large upfront premiums for expensive and often worthless credit insurance were commonly imposed on borrowers in the subprime market and financed into the principal of the mortgage. These premiums, which created fee income for lenders but stripped valuable home equity from consumers, are prohibited by the Dodd-Frank Act. No residential mortgage loan or open end credit plan secured by the consumer's principal dwelling may include financing, directly or indirectly, of any "credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract," with some limited exceptions. Act §1414(a).

2. Mortgage Servicing Rules

a. Requires 6-month notice before mortgage interest rate resets from fixed to variable

In an effort to avoid an unforeseen payment shock and to clearly inform borrowers who may misunderstand the terms of their teaser rate loans, lenders and servicers are now required to provide 6 months' advance notice to consumers when the in

terest rate on any mortgage secured by the consumer's principal residence will switch from a fixed rate to a variable rate. Act §1418(a). The disclosure must include information about how the new rate will be calculated, a good faith estimate of the new monthly payment, and a list of alternatives the borrower has prior to the adjustment, including refinancing, renegotiation, and pre-foreclosure sale.

b. Requires certain disclosures in monthly statements

For the first time, lenders, servicers, or assignees are required to provide regular billing statements to consumers with residential mortgage loans. Without this requirement, many subprime borrowers were left in the dark about the status of their loans. These statements must include: (1) the amount of the principal owed under the mortgage, (2) the current interest rate in effect for the loan, (3) the date on which the interest rate may adjust, (4) the amount of any prepayment fees to be charged, if any, (5) a description of any late payment fees, (6) contact information the borrower can use to obtain more information about the loan, (7) contact information for counseling agencies, and (8) any other information prescribed by the Bureau. The requirement of section 1420 may be met with a coupon book that includes substantially the same information.

c. Requires establishment of an escrow account for payment of taxes and insurance for certain higher-cost mortgages

A common abuse in the subprime market was refinancing a borrower from a loan with a monthly payment that included taxes and insurance into a loan without an escrow for these payments. Many borrowers unwittingly signed up for what appeared to be loans with lower monthly payments, only to discover their payments were actually higher once taxes and insurance were added. The Dodd-Frank Act generally mandates that, for at least five years, creditors establish an escrow for taxes and insurance for residential mortgage loans. Act §1461. Unless otherwise required by state or federal law, mandatory escrows can be avoided for mortgages with APRs within certain limits that also meet the definition of qualified mortgages. Under this provisiton, if a borrower chooses to waive the escrow requirement after five years, the creditor must provide written disclosures describing the consumer's obligations and the implications of not having an escrow account.

d. Prohibits force-placed insurance and other abusive practices by servicers

Several servicer prohibitions are added by the Dodd-Frank Act through amendments to RESPA. For example, force-placed insurance abuses are banned. Act §1463. Force-placed insurance refers to hazard insurance that is imposed by the servicer only when the borrower fails to renew or maintain hazard insurance as required by the mortgage contract. This expensive insurance is often forced on borrowers who are maintaining their own hazard insurance. Because of the expense of these premiums, force-placed insurance practices can push a borrower into default and foreclosure.[48] Going forward, a servicer cannot obtain force-placed hazard insurance unless it has a reasonable basis to believe the borrower has failed to obtain insurance required by the contract and has met each of the elaborate procedural predicates imposed by the Act. This section also prohibits other practices, such as charging fees for responding to a valid written request by the consumer and imposes quicker response times to borrower inquiries.

3. Remedies for Violations of Rules

a. Expands availability of defenses to foreclosure

Under section 1416, a violation of the Dodd-Frank Act's steering incentive and ability to pay provisions gives rise to an affirmative claim against the mortgage originator. However, for many borrowers, the most important remedy is the ability to protect their homes from foreclosure resulting abusive practices. A violation of these two provisions can be asserted as a defense by recoupment or set-off in any judicial or non-judicial foreclosure proceeding, as well as an action to collect the debt in connection with the loan. Act §1413. Recognizing that many borrowers are not aware of violations until they get legal help in connection with a debt collection or foreclosure action, the Dodd-Frank Act ensures that this defense is not subject to the statute of limitations governing a private action for damages. This also should substantially dampen the secondary market's interest in non-qualified mortgages, which will always be subject to an unsettled enforcement question. It should be noted, however, that the amount of recoupment or set-off cannot exceed what the consumer would have been entitled to before the statute of limitations for damages had run. Nevertheless, this provision closes the gap created by courts in some non-judicial foreclosure states, which have refused to allow homeowners to raise time-barred claims defensively in actions filed to stop a non-judicial foreclosure.

b. Changes to statutory damage caps and the statute of limitations for certain provisions

The Act also enhances the recourse borrowers have against lenders in the event a lender violates Section 129 of TILA. To start, the damages cap in class actions was raised from $500,000 to $1,000,000. Act §1416(a). The Act provides a three-year statute of limitations for violations of Sections 129, 129B, and 129C of TILA, which includes the new ban on steering incentives, the requirement that lenders assess ability to repay, and HOEPA. Act §1416(b). The provision gives borrowers more time to discover violations than the existing sections of TILA, which impose a one-year statute of limitations on claims for monetary damages. 15 U.S.C. §1640(e). The one-year statute of limitations has oftentimes led to the dismissal of potential TILA claims from court.[49] In addition, the Act increases the class action damages cap for RESPA servicing violations to $1 million, and individual damages to $2,000. Act §1463. While these increases may not be sufficient to make these cases attractive to contingency-fee lawyers (important since many consumers will not be able to pay lawyers' fees upfront), they represent an improvement over prior limits.

4. New Restrictions on "High-Cost" Loans through Amendments to HOEPA

In addition to amending other sections of TILA, the Dodd-Frank Act amends the high-cost mortgage provisions of TILA, known as HOEPA, and expands its scope in several key ways. First, in addition to refinance loans, HOEPA now covers any loan secured by the consumer's principal dwelling, including for the first time purchase loans, open-end loans and any other configuration of home-secured loan other than a reverse mortgage. Act §1431. It also requires for the first time that borrowers must undergo pre-loan counseling before taking out a high-cost mortgage under HOEPA. Act §1433. In addition, under the current version of HOEPA, loans are subject to HOEPA if they exceed either an APR trigger or a "points and fees" trigger. The Act adjusts the two current triggers and adds a third trigger to significantly enlarge HOEPA's coverage. *Id.* As a practical matter, as will be explained below, the Act will eliminate virtually all

HOEPA loans except those based on the APR trigger.

a. APR Trigger

The Dodd-Frank Act lowers the APR trigger for first liens by 1.5 points so that first lien loans with an APR that is more than 6.5 percentage points above the comparable benchmark APOR are now subject to HOEPA's restrictions.[50] Act §1431. Quite significantly, and again for the first time, loans with variable interest rates will have their HOEPA coverage determined by calculating the maximum rate permitted during the loan term, instead of looking at the initial rate only.

b. Points and Fees and Prepayment Penalty Triggers

The Act's treatment of the points and fees and prepayment penalty triggers is noteworthy. Traditionally, loans triggered HOEPA coverage predominantly by tripping the points and fees trigger, which occurs when the points and fees charged on the loan—either through the borrower's cash payment, through fees that are financed into the principal of the loan, or a combination of the two—exceed 8% of the total loan amount. The Act lowers the points and fees trigger—from 8 % to 5% of the total loan amount[51]—and expands its definition.[52] The Act also adds as a third HOEPA trigger for prepayment penalties extending beyond 36 months from closing of the mortgage, and then prohibits such prepayment penalties outright.[53]

Based on the lowering of the points and fees and addition of the prepayment triggers, it would be reasonable to assume that the new rules will capture more loans under HOEPA. Nothing could be farther from the truth, however, because while expanding the trigger, the Act also bans most HOEPA points and fees loans by prohibiting the direct or indirect financing of any points and fees. Act §1433. HOEPA points and fees instead will have to be paid in cash at settlement, which will make these transactions practically impossible for the majority of consumers. Thus, rather than being compensated for increased risk through higher points and fees, lenders will increase their compensation through a higher APR. As a result, HOEPA coverage in the future is more likely to be through the APR trigger than the points and fees trigger. Moreover, no HOEPA loans will contain prepayment penalties. Consequently, where consumers take out high-APR HOEPA loans, they will have the ability to refinance later without suffering reduced equity from upfront fees or back-end prepayment penalties. Thus, the Act ensures that lenders will no longer be able to make high cost HOEPA loans that strip equity through upfront fees or through prepayment penalties.

Furthermore, the definition of HOEPA points and fees was also expanded by the Act to include "all compensation paid by consumer or creditor directly or indirectly to mortgage originator,"[54] Act §1431, thus settling the longstanding controversy over whether yield spread premiums paid directly by the lender to the broker (and indirectly by the borrower through a higher interest rate) constitute points and fees under HOEPA.[55] The new language unambiguously includes YSPs within the definition of HOEPA points and fees. Recall that the Dodd-Frank Act prohibits YSPs for all residential mortgage loans. *See* §1413. However, YSPs can be charged in open-end credit plans and in transactions where the borrower pays no upfront fees and all fees are paid instead through a higher interest rate. Thus, YSPs in such loans will potentially trigger HOEPA coverage.

In the nine month time frame between when the CARD Act was passed until it took effect, the average APR on credit cards increased about two full percentage points.

The bottom line for HOEPA loans is this: purchase loans are in, open-end loans are in, and manufactured home loans are in. After the Dodd-Frank Act, the predominant HOEPA loan will likely be a high APR loan, and there may also be some HOEPA loans where borrowers are willing to pay the points and fees up front or where all points and fees are paid in the form of YSPs. The broadest impact on the mortgage market, however, will come from the ban on financing any points and fees in HOEPA, which will markedly restrain points and fees triggered-HOEPA loans. Lenders also can be expected to give the points and fees trigger a wide berth because it will constitute an outright violation of HOEPA that lenders will trigger, regardless of their disclosures, by originating a loan with points and fees that are at least partially financed and total 5% of the loan amount.[56] Because of this risk, we expect lenders will be less willing to make loans approaching the trigger than they have in the past. Some lenders might impose limits of 4.5 points or lower to avoid the HOEPA penalty, and more conservative lenders might limit themselves to qualified mortgages and avoid the problem altogether. Only time will tell whether these restrictions will effectively eliminate abusive high cost loans or whether loan originators will exploit any gaps in the mortgage rules to continue originating predatory mortgages.

5. CFBP's regulatory authority with respect to mortgages

The Dodd-Frank Act not only expands the substantive protections and prohibitions on mortgage lending, but also vests broad rulemaking authority in the CFPB (but until the designated transfer date, the Federal Reserve) with respect to regulating residential mortgage lending. Section 1405 of the Act states:

> IN GENERAL.—The Board shall, by regulations, prohibit or condition terms, acts or practices relating to residential mortgage loans that the Board finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section and section 129C, necessary or proper to effectuate the purposes of this section and section 129C, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections, or are not in the interest of the borrower.

The CFPB, therefore, will have ample authority to go beyond the specific provisions in the Act to limit mortgage terms and practices it finds to be unfair and ensure the availability of "responsible, affordable" mortgages. Any regulations must also be consistent with the purpose of amended TILA sections 129B and 129C: "[T]o assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive." Act §1402(a). Thus, while the specific changes to mortgage lending law in 129B and 129C are significant, even more significant is the Dodd-Frank Act's sweeping grant of authority to the BFCP to protect consumers through the ongoing regulation of residential mortgage.

A. Credit and Debit Cards

There was much maneuvering by banks in advance of the recent enforcement of the Credit Card Accountability

Responsibility and Disclosure Act ("CARD Act").[57] The companies jettisoned less profitable customers, raised interest rates and increased payment minimums. In the nine month time frame between when the CARD Act was passed until it took effect, the average APR on credit cards increased about two full percentage points, while issuers added annual fees, increased balance transfer and cash advance fees, and switched from fixed to variable rates to give themselves the flexibility to raise rates in the future.[58] The Dodd-Frank Act vests the CFPB with authority, through rulemaking and enforcement, to prevent these kinds of regulatory dodges in the future.

On its face, the Dodd-Frank Act deals with only a very limited set of credit and debit card practices: what fees can be charged by card issuers, payment card networks, and merchants in connection with consumers' use of payment cards. This is a sea change for merchants, who will be permitted to impose minimum purchase amounts (up to $10) without risk of losing access to any network, so long as the merchant does not discriminate between different card networks (e.g. Visa or MasterCard) or issuers (e.g. Bank of America). Act §1075(a). CFPB, however, can set regulations that allow merchants to impose minimum purchase amounts above $10. Merchants also may offer discounts to cash or debit card purchasers without interference from payment card networks, but, again, they cannot favor different types of credit card networks or card issuers. Merchants thus have more leeway in the way they accept payment cards, as they can both set limits on when customers may use them and award discounts for their use. Perhaps most important for merchants, and hopefully through them to consumers as well, the law now requires that fees paid by payment card networks to issuers for their participation in the transaction—"interchange transaction fees"—must be reasonable and proportional to the cost incurred by the issuer during the transaction. Act §920(a)(2). The CFPB has authority to regulate interchange transaction fees, Act §920(a)(1), and must conduct a rulemaking within nine months to establish standards in assessing the reasonability of such a charge, Act §920(a)(3). Assuming issuers do not recoup the cost of that rule through other novel fees, fewer costs should be passed down to merchants and consumers.

C. Fair Lending

The section of the law establishing the Office of Fair Lending and Equal Opportunity gives the CFPB authority to oversee and enforce federal laws "intended to ensure the fair, equitable, and nondiscriminatory access to credit for both individuals and communities that are enforced by the Bureau …" Act §1013(2)(A). The Dodd-Frank Act also enhances the fair lending reporting requirements under the Home Mortgage Disclosure Act, which only required the reporting of race, ethnicity, and gender of applicants and the application decision (as well as additional information for HOEPA-covered loans). Entities now have to report a borrower's credit score, age, total points and fees, loan pricing, prepayment penalty information, house value, period of introductory interest rate, interest-only or negative amortization information, term of the loan, and channel of origination. Act §1094.

Whereas reporting requirements had been tailored to the question of whether minority borrowers are discriminated against in *access* to credit, the new reporting requirements allow regulators to better evaluate the question of whether minority borrowers receive credit *on worse terms* when they do receive credit, and, for the first time, allow regulators to see if older consumers are discriminated against in credit transactions. Since the subprime crisis began, a number of studies have explored the disproportionate impact that the foreclosure crisis has had on people of color.[59] Some, in the context of litigation, have used available lending data to show that African American and Latino borrowers received more abusive and unfair loans than their white counterparts, even when controlling for default risk indicators such as the borrower's credit score.[60] In other words, it may be that racial minorities were disproportionately steered—by brokers and lenders—into more expensive and toxic loans than they qualified for in the years before the subprime crisis, and have therefore suffered a disproportionate financial loss since. The more detailed information required under section 1094 should deter disparate pricing in the future, as well as provide a richer database for regulators to observe trends in pricing and access to credit and engage in additional enforcement, as appropriate.

III. Preemption:

Another hotly contested provision of the Dodd-Frank Act relates to the ability of state enforcers – whether banking regulators or attorneys general – to enforce both state and federal standards. While banks and some Democrats complained that the Act would create a patchwork of rules, state enforcement remain vigorous and a marked departure from recent federal policy.

Preemption removes neighborhood cops from the consumer protection beat.[61] State officials are consumers' first responders; they are closer to consumers and often the first to become aware of new and devastating consumer scams. State attorneys general have been responsible for some of the most significant settlements for predatory lending: Ameriquest ($325 million), Household ($484 million), and, most recently, Countrywide ($8.6 billion, with projected value of loan modifications).

State leadership emerged in the absence of any serious enforcement by OTS and OCC.[62] And it occurred despite OTS's and OCC's aggressive efforts to assert their broad preemptive powers.[63] Over the last decade, the OCC, under the National Banking Act ("NBA"), and OTS, under the Home Owner's Loan Act ("HOLA"), drafted rules that claimed exclusive enforcement jurisdiction over the financial institutions they regulated. In *Cuomo v. Clearing House*, 129 S. Ct. 2710 (2009), the Supreme Court reined in federal regulators, holding that the NBA did not preempt the enforcement of state laws of general applicability, including consumer protection statutes (though it did preclude state attorneys general from issuing subpoenas to national banks).

The Dodd-Frank Act stakes out a clear role for state consumer financial protection, tipping the scales from, rather than toward, preemption. It takes *Clearing House* a step further, as

CFPB regulations will not preempt state consumer protection laws unless they are inconsistent, and more protective state laws are not inconsistent. Act §1041. State attorneys general, and, as applicable, state regulators, can enforce not only their own non-preempted state laws against federally-chartered banks and thrifts, but also the CFPB regulations (though not the general ban on unfair, deceptive, or abusive acts or practices in the absence of the rule).[64] Act §§1042(a)(2), 1047. Thus, federal law and regulations provide both an engine and a floor, not a ceiling, for enforcement.

In a strong break from past practice, the Act also amends the NBA and HOLA, to ensure that these banking laws will not be interpreted to preempt stronger state consumer financial laws[65] unless the state law discriminates against national banks or federal thrifts, "prevents or significantly interferes" with the institution's ability to do business, or is expressly preempted by federal law. In effect, the Act adopts the Supreme Court's standard in *Barnett Bank of Marion County, N.A. v. Nelson, Florida Ins. Commissioner, et al.*, 517 U.S. 25 (1996). The Dodd-Frank Act only preempts state laws to the extent that they are inconsistent with the Act; the fact that the state law is more protective than the Act does not, on its own, make it inconsistent. Act §1041(a). Before determining that a state consumer financial law is preempted, OCC must consult with the CFPB. Act §1044, adding new §5136C(b)(3)(B). To ensure thoughtful deliberation and accountability, the Act requires that the Comptroller of Currency make any preemption decisions, which cannot be delegated to any other officer or employee and must be based on substantial evidence, and any OCC preemption determination must be supported by "substantial evidence" finding that the *Barnett* standard is met. Act §1044. Perhaps most critical in the long run, this section also directs that courts reviewing an OCC preemption finding not simply defer to the agency, but consider the thoroughness of its review, the validity of its reasoning, and its consistency with prior determinations, among other factors. Thus, the rule assures that courts do not give automatic deference to the OCC with respect to its preemption determinations. Preemption determinations must be reviewed and re-published within 5 years and the OCC must, at least quarterly, publish an updated list of all current preemption determinations, identifying the specific scope and impact of each determination. Act § 1044.

While codifying two Supreme Court decisions, the Dodd-Frank Act reverses another one. In *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007), the Supreme Court held that state laws are preempted with regard to operating subsidiaries of national banks to the same extent that such laws are preempted for the parent bank. The Dodd-Frank Act overturns the ruling in *Watters*, stating that neither the Act nor Section 24 of the Federal Reserve Act "preempt[s], annul[s], or affect[s] the applicability of any State law to any subsidiary or affiliate of a national bank." Act §1044(a).

Thus, the law creates considerably more space for state enforcement activity, limiting and more clearly defining the circumstances in which state action will be found to be preempted.

IV. Rating agencies and Securitizers

Though rating agencies typically belong on the investor, not consumer, side of the ledger and would otherwise be outside the scope of this article, steps taken to rein in the rating agencies are worth noting because, but for the rating agencies' blessing of risky mortgage securities, originators would never have been able to fund and pass off those mortgages.[66] At the heart of the problem, according to commentators and former employees, were deeply flawed rating methodologies ill-suited to new mortgage-backed securities and a fundamental conflict of interest in how rating agencies were paid. Just as the OCC and OTS became beholden to the regulated entities that paid their fees, credit rating agencies ("CRAs") are dependent on the issuers of securities to pay their fees. Because investment banks cannot live with non-investment grade ratings, CRAs face internal and external pressure to provide higher ratings that will satisfy their clients. During the peak of the housing bubble, the drive for market share and profits seemed to overwhelm CRAs' duty of accuracy.[67]

The Dodd-Frank Act establishes an Office of Credit Ratings at the Security Exchange Commission ("SEC") with the authority to administer the rules of the SEC with respect to CRAs, to promote the accuracy of credit ratings, and to ensure that credit ratings are not influenced by conflicts of interest. Act §932(a)(8). Several of the provisions in section 932 aim to increase the transparency of the credit-rating process. For example, CRAs are now required to disclose their rating methodologies and the performance of previous ratings for each type of security or money market instrument. Act §932(a)(8). The response from the three major CRAs—Standard & Poor's, Moody's Investors Service and Fitch Ratings—following passage of the Dodd-Frank Act suggests they may have had little faith in their own ratings methodologies. Immediately after Congress passed the law, the three agencies prevented bond issuers from publishing their ratings for fear of liability risks.[68]

Furthermore, Section 932 also gives the SEC the authority to suspend or de-register a CRA if it finds that the CRA does not have the ability to produce ratings with integrity. CRAs are required to submit annual reports that detail their compliance with the law, as well as any changes to their code of ethics. Act §932(a)(5). Despite the general requirements outlined in the law, much of the specific content of the regulations were left to the rulemaking authority of the SEC. The SEC is currently conducting a 2-year study to create new mechanism that will prevent Asset Backed Security (ABS) issuers from picking the agency they think will provide the highest rating. If the SEC cannot determine how to match raters with firms while eliminating rating agency conflicts, the SEC will appoint a panel to establish a random process. Within a year, the SEC must issue rules on conflicts of interest, specific disclosures, and analyst qualifications (and various other reports are also required, including one on how CRAs are to be assigned to issuances).

The law also sets significant corporate governance requirements for CRAs. At least half of a rating agency's board of directors, which sets policies with respect to how ratings are set and how conflicts of interest are avoided, must be "independent" (meaning the directors are not associated with the CRA and do not receive compensation from it) and directors' compensation cannot be tied to the agency's performance. Act §932(a)(8). Section 933 enhances the liability of CRAs by allowing investors to sue rating agencies for a knowing or reckless failure to investigate the facts relied upon to make the rating, or failure to obtain reasonable verification of the facts from a credible source. Act §933(b). Ratings are no longer considered "forward-looking statements" under the Exchange Act and the law rescinds Securities Act Rule 436(g), making analysts liable in the same manner as accountants when ratings are included in registration statements. Act §933(a). Many of the requirements to use ratings provided by registered Nationally Recognized Statistical Rating Organiza-

The Dodd-Frank Act only preempts state laws to the extent that they are inconsistent with the Act.

tions ("NRSROs") were eliminated under the Act, encouraging investors not to rely on ratings. Finally, the law requires CRAs to consider information relevant to their ratings that come from credible third party sources. Act §935.

This same discipline is also at heart of the Dodd-Frank Act's risk-retention provision. Under the law, companies that sell mortgage-backed securities must retain at least 5% of the credit risk in each underlying asset, unless the underlying loans are "qualified residential mortgages" (the term is still to be defined by the CFPB, but it is meant to cover lower-risk loans than the ones that characterized the subprime mortgage market). Act §15G(b), (c). The idea behind the rule is that securitizers will be less likely to bundle toxic mortgages and conceal their risk if they are required to suffer some of the consequences if the loans default. Presumably, this would also have a trickle-down effect on loan origination; in other words, if securitizers refuse to package risky mortgages for fear of bearing the risk, lenders will be less likely to originate such mortgages because they will be unable to sell them to investors. The key question, however, will be whether the 5% risk retention is enough to outweigh the potential profits from the other 95%.

V. Miscellaneous:

Several other provisions of the Dodd-Frank Act relating to consumer protections are worth noting, even briefly.

A. Insurance

Section 502 of the Act creates the Federal Insurance Office within the Treasury Department to gather information (including by subpoena) about the insurance industry (excluding health insurance), including access to affordable insurance products by minorities, low- and moderate-income persons, and underserved communities. The Office is to issue a report within 18 months with findings and recommendations regarding the costs, benefits, and feasibility of federal insurance regulation. In contrast to the other preemptive provisions of the Dodd-Frank Act, this section begins to test a federal role in what historically has been a state regulated arena. This section, however, specifically prevents the federal government from overturning state rules covering rates, premiums, underwriting, sales practices, coverage requirements, state antitrust laws or solvency requirements.

B. Funding

The law earmarks significant funding for consumer-related projects and functions. In addition to the CFPB's budget, the Dodd-Frank Act:

- Dedicates $1 billion for emergency mortgage relief to provide bridge loans to qualified unemployed homeowners with reasonable prospects of employments to help them make mortgage payments in the interim. Act §1496(a).
- Dedicates another $1 billion to cities and states for neighborhood stabilization to rehabilitate, redevelop, and reuse abandoned and foreclosed property. Act §1497(a).
- Authorizes a HUD program to make grants to provide foreclosure legal assistance to low and moderate income homeowners. Act §1498(a).

C. Appraisals

Inaccurate and improperly-influenced appraisals were among part of the risky practices that characterized the subprime mortgage market preceding the foreclosure crisis. In many instances, lenders influenced appraisers to overvalue properties in order to satisfy their underwriting standards and extend credit to some borrowers.[69] Inflated appraisals not only led to the undercollateralization of mortgages, it also overextended borrowers who were paying more for their mortgages than their properties were actually worth. Loans with inaccurate appraisals, therefore, contributed to the foreclosure crisis as many borrowers were often unable to afford loans that lenders green-lighted through inflated appraisals.[70]

Under section 1472 of the Dodd-Frank Act, appraisals must be independent. An appraisal is not independent if the appraiser is subject to compensation, coercion, intimidation, instruction, or bribery by a party with an interest in the underlying transaction for the purpose of basing the appraisal on anything other than the judgment of the appraiser. Moreover, misrepresentation of the value of the property for the purposes of extending credit and withholding or threatening to withhold timely payment to the appraiser violate the Act's requirement of appraisal independence. The law also prohibits conflicts of interest with respect to appraisals, and no appraiser conducting an appraisal "may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal." This section covers appraiser compensation as well; lenders and their agents must compensate appraisers at a rate that is customary and reasonable. A creditor who knows of a violation of any of the above rules may not extend credit to a consumer, unless it documents that it followed reasonable diligence in finding that the appraisal did not materially misrepresent the value of the dwelling. The penalty for violation of §1472 is a $10,000 civil fine for each day the violation continues, and $20,000 for second violations. Finally, the CFPB is required to issue interim final rules within 90 days of date of enactment specifying particular acts that violation appraisers' independence.

The Dodd-Frank Act also prescribes other rules with respect to appraisals. Before a lender can extend credit for a "higher-risk" mortgage,[71] section 1471 requires it must first obtain a written appraisal of the property in accordance with the new section 129H of TILA. First, the appraisal must be done by a physical visit to the property and viewing of the interior and the borrower is entitled to one free copy of each appraisal report. Second, where a seller is flipping a property within 180 days, a second appraisal is required at no cost to the consumer. The second appraisal must analyze the difference in price, changes to the property, and changes in the market since the property was purchased. Violations of section 129H are subject to a civil penalty of $2,000.

D. Loan Modifications

Many consumers complain that they were wrongly or inexplicably denied a HAMP modification by their servicer. Because much of the loan modification process remains a black box, consumers, advocates, and counselors have no ability to check servicers' math, making their decision making both mysterious and accountable. Leaving no law untouched, the Dodd-Frank Act made adjustments to increase the transparency of the Home Affordable Modification Program ("HAMP"). Act §1482 (a)(c). First, the Act requires the Secretary of the Treasury to revise its HAMP supplemental directives and other guidelines to require any lender or servicer who denies a HAMP modification following a request from

The Consumer Financial Protection Bureau and the substantive restrictions on mortgage lending could have prevented the last financial crisis.

the consumer to provide the consumer with the input data in a Net Present Value (NPV) analysis.[72] Act §1482. Not only that, but the Secretary must create a website with an NPV calculator that can be used by consumers. Finally, the Act mandates that the Secretary make public data it receives from lenders and servicers participating in the HAMP program. Act §1483.

III. Conclusion

The structural and substantive reforms contained in the Dodd-Frank will unfold over the coming years through hundreds of rules and studies and the activity of thousands of regulators, lobbyists, and advocates. So, while it's far too soon to fully describe, let alone pass judgment on, the scope and impact of this law, it clearly will impose focused oversight and real discipline on financial institutions' consumer financial services. The Consumer Financial Protection Bureau and the substantive restrictions on mortgage lending (and related mortgage-related services, from appraisals, to credit ratings, to securitization) could have prevented the last financial crisis. The true test, also hopefully years in coming, will be whether the Dodd-Frank Act can protect consumers' interests and avert the next disaster.

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, (2010).
2 Ruth Mantel, "What the New Consumer Financial Bureau Means for You," Marketwatch.com, 7/15/07, *available at* http://www.marketwatch.com/story/what-bank-reforms-consumer-bureau-means-for-you-2010-07-15.
3 *Id.*
4 *See generally*, Jim Meyers, "US Faces 'Disaster' from Financial Reform Bill, Bachmann Warns," Newsmax.com, 7/27/10, *available at* http://www.newsmax.com/Headline/michele-bachman-financial-reform-bill-disaster-barack-obama/2010/07/27/id/365805.
5 Act §1021.
6 Act §1002. "Consumer financial product or service" is broadly defined as any financial product or service provided for use by consumers primarily for personal, family, or household purposes. Act §1002(5). This includes: extending, servicing, acquiring, purchasing, selling, or brokering credit; leasing; real estate settlement services and appraisals; deposit taking and money transmitting; cashing, collecting, or guaranteeing checks; financial data processing; and debt settlement and certain kinds of debt collection, among others. Act §1002(15).
7 Act §1052(b) and (c).
8 This includes: the Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C. 3801 et seq.); the Consumer Leasing Act of 1976 (15 U.S.C. 1667 et seq.); the Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.), except with respect to section 920 of that Act; the Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.); the Fair Credit Billing Act (15 U.S.C. 1666 et seq.); the Fair Credit Reporting Act (15 U.S.C. 1681 et seq.), except with respect to sections 615(e) and 628 of that Act (15 U.S.C. 1681m(e), 1681w); the Home Owners Protection Act of 1998 (12 U.S.C. 4901 et seq.); (H) the Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.); subsections (b) through (f) of section 43 of the Federal Deposit Insurance Act (12 U.S.C. 1831t(c)–(f)); sections 502 through 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6802–6809) except for section 505 as it applies to section 501(b); the Home Mortgage Disclosure Act of 1975 (12 U.S.C. 2801 et seq.); the Home Ownership and Equity Protection Act of 1994 (15 U.S.C. 1601 note); the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.); the S.A.F.E. Mortgage Licensing Act of 2008 (12 U.S.C. 5101 et seq.); the Truth in Lending Act (15 U.S.C. 1601 et seq.); the Truth in Savings Act (12 U.S.C. 4301 et seq.); section 626 of the Omnibus Appropriations Act, 2009 (Public Law 111–8); and the Interstate Land Sales Full Disclosure Act (15 U.S.C. 1701).
9 There are a number of exemptions from CFPB jurisdiction, including real estate brokers, manufactured home retailers, attorneys, accountants, tax preparers, and car dealers. Act §1027. Persons regulated by the Securities and Exchange Commission, the Commodity Futures Trading Commission, or state insurance regulators, such as broker-dealers and investment companies, also are excluded. Many of these exemptions are only partial. For example, car dealers are sometimes covered under the statute and sometimes not, depending on their activity. A car dealer is subject to CFPB jurisdiction when it extends credit to purchase or lease a vehicle and routinely keeps the finance account in house or assigns it to an affiliated lender. Act §1029(b). On the other hand, a car dealer is exempt from CFPB when it provides or arranges credit to its customers to purchase or lease a vehicle and the purchase contracts are routinely sold to an unaffiliated third party lender. Act §1029(a).
10 Large depository institutions include banks, thrifts, and credit unions with more than $10 billion in assets. Act §1025(a). These institutions—which include entities such as Bank of America and Wells Fargo—accept deposits and extend credit to consumers, among other activities.
11 Small depository institutions include banks, thrifts, and credit unions with $10 billion in assets or less. Act §1026(a). These institutions engage in similar activities as large depositories, but at a smaller scale. One example of a small depository is a community bank.
12 Non-depository institutions include: mortgage originators, brokers, and servicers; private education loan providers; payday lenders; "large participants" in the market for other consumer financial products, to be defined by CFPB regulation; and any individual provider not otherwise covered that CFPB has reasonable cause to believe is engaging in conduct that poses risk to consumers. Act §1024(a)(1).
13 Act §1022.
14 To designate conduct "unfair," the Bureau must have a reasonable basis to conclude that the conduct causes, or is likely to cause, substantial injury to consumers that: (1) cannot be reasonably avoidable and (2) is not outweighed by countervailing benefits to consumers or competition. Act §1031(c).
15 Act §1031.

16 FTC Act §57a(f). Enforcement of the FTC Act was vested in each depository's respective supervisory agency. *See* FTC Act §57a(f).

17 To deem a practice "abusive," the Bureau must find that it materially interferes with a consumer's ability to understand a term or condition of the product or service, or takes unreasonable advantage of the consumer's lack of understanding of the risks, costs, or conditions, or the inability of the consumer to protect his or her interests in choosing the product or service, or the reasonable reliance by the consumer on the covered person to act in the interest of the consumer. Act §1031(d).

18 See, e.g., Act §§1025(e), 1022(b)(2)(B), 1061(b)(5)(D).

19 There is one notable exception: the CFPB must reach agreement with the FTC for coordinating enforcement actions against non-banks, which are subject to the FTC's concurrent jurisdiction. Act §1061(b)(5).

20 The systemic risk council is comprised of: Secretary of Treasury (Chair), Federal Reserve Chair, Comptroller of the Currency, CFPB Director, SEC Chair, FDIC Chair, Commodity Futures Trading Commission Chair, Federal Housing Finance Agency Director, NCUA Chair, and an independent member with insurance expertise, to be appointed by President and subject to confirmation. Act §111.

21 Some smaller non-banks will not be subject to CFPB supervision. A CFPB rule, adopted after consultation with the FTC, will define these "smaller participants." Act §1024 (a)(1)(B).

22 Act §1026(c).

23 Act §1026(d).

24 The Dodd-Frank Act creates a single national hotline for all consumer complaints regarding financial products and services, which should facilitate the collection of consolidated data on consumer complaints. Act §1013(b)(3)(A).

25 Prohibits mandatory arbitration in subtitle. In text: The Dodd-Frank Act flatly prohibits mandatory arbitration in mortgage and home equity loans without the need for any further study or rulemaking. Act § 1414.

26 Act §§1022(b)(1); 1012(b)(1), (c)(2)(A), (c)(2)(B).

27 The Act does require the Department of the Treasury, however, to conduct a study on ending the conservatorship of Fannie Mae and Freddie Mac and reforming the housing finance system. Act §1074.

28 *See generally*, Amanda Quester & Kathleen Keest, *Looking Ahead after Watters v. Wachovia Bank: Challenges for the Lower Courts, Congress, and the Comptroller of Currency*, 27 Ann. Rev. Banking & Fin. L. 187 (2008).

29 Act §1061(b)(5)(C). This is an exception to the CFPB's exclusive rulemaking authority. Act §1022(b)(4). The FTC's rulemaking authority under the "enumerated statutes" is transferred to the CFPB. Act §1061(b)(5(A),(B). The FTC Act itself, however, is not an "enumerated statute."

30 This is no small matter: there are currently more than 750 federal thrifts and 400 state thrifts.

31 To extend the designated transfer date beyond one year, the Treasury Secretary must submit to the applicable Congressional committees three items: (1) a written determination that the orderly implementation of the CFPB is not feasible within one year, (2) an explanation as to why the extension is necessary, and (3) a description of the steps to be taken in order to effect an orderly and timely implementation of the CFPB. Act §1062(c)(2)(A),(B),(C).

32 All of the regulations under the Mortgage Reform and Anti-Predatory Lending Act must be set in final form no later than 18 months after the designated transfer date, and must take effect no latter than 12 months following their date of issuance. Act §1400(c).

33 Note that "qualified mortgages" is defined somewhat differently depending on the product or practice being regulated. The different definitions will be explained below where relevant.

34 "Residential mortgage loan" refers to "any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling, other than a consumer credit transaction under an open end credit plan." Act §1401. Note this definition is broader than the existing TILA definition of "residential mortgage transaction," 15 USC §1602(w), which refers solely to purchase-money mortgages. The unfortunate similarity of these two different terms is likely to lead to confusion.

35 "Mortgage originator" is quite broadly defined under the Act to mean "any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain—(i) takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan." Act §1401. The definition covers mortgage brokers. The definition does not include lenders, servicers, real estate brokers (unless compensated by a mortgage lender or broker), or clerical/administrative employees of the originator. *Id.*

36 *See* Les Christie, *Yield Spread Premiums Can Bite You*, Money.com, 7/5/2007, *available at* http://money.cnn.com/2007/07/02/real_estate/yield_spread_premium_demystified/index.htm.

37 Although section 1403 permits YSPs in some limited circumstances, YSPs will now be counted as points and fees under HOEPA and may trigger HOEPA's prohibitions. *See* discussion of HOEPA *infra*.

38 The CFPB can waive or provide exceptions to this clause if it would be in the interest of consumers and in the public interest. Act §1403.

39 "Average prime offer rate" refers "to the average prime offer rate for a comparable transaction as of the date on which the interest rate for the transaction is set." Act §1412(b). The CFPB must publish the APOR and update it weekly. Act §1414(a).

40 See, e.g., Act § 1414(a).

41 *See, e.g.*, *Commonwealth v. Fremont Investment & Loan*, 897 N.E. 2d 548 (Mass. 2008); *Commonwealth v. Option One Mortg. Co.*, 916 N.E. 2d 422 (Mass. App. 2009).

42 Stephanie Fitch, "No-Doc Mortgages Are Back?!," Forbes, 7/2/10, available at http://www.forbes.com/2010/07/02/return-liar-loans-personal-finance-no-doc_print.html.

43 Did Securitization Lead to Lax Screening? Evidence From Subprime Loans (with Benjamin Keys, Tanmoy Mukherjee and Vikrant Vig). Quarterly Journal of Economics, 125(1), 2010, *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1093137.* Research shows that income of "low/no doc" borrowers was typically embellished by 15-19%, whether by borrowers or originators. See Wei Jiang, Ashlyn Aiko, and Edward Vyslaul, *Liar Loans? Effects of Origination Channel on Falsification on Mortgage Delinquency*, 2/10; Bob Tedeschi, *New Rules Coming Soon*, 9/25/19. (A recent sample of 100 stated income loans was compared to IRS records [sic] found that 90% of the income was exaggerated by 5% or more. Almost 60% of the stated amounts were exaggerated by more than 50%. See Steven Krystofiak, President, Mortgage Brokers Association for Responsible Lending, Statement to the Federal Reserve, 8/1/2006.)

44 *See*, for example, "Saying Yes, WaMu Built Empire on Shaky Loans," by Peter S. Goodman and Gretchen Morgenson, which appeared in the Wall Street Journal on December 28, 2008. A Wahington Mutual mortgage processing center supervisor recounts the ease with which the bank approved borrowers with questionable stated incomes. *See also,* "My Personal Credit Crisis" by Edmund Andrews, which appeared in the New York Times

on May 17, 2009. The author provides a detailed description of his personal experience in qualifying for a loan far beyond his financial means by hiding, forging, and strategically managing information with the help of his mortgage broker.

45 In determining a consumer's ability to repay the loan, the consumer's credit history, current and expected income, expenses, debt-to-income ratio, employment, will be considered. Revised §129C (a)(2) of TILA.

46 *See* Eric Stein, Coalition for Responsible Lending, *Quantifying the Economic Cost of Predatory Lending*, 8 (2001), *available at* http://www.selegal.org/Cost%of%Predatory%20Lending.pdf.

47 The Act allows qualified mortgages to charge prepayment penalties of up to 3% of the outstanding balance for prepayment in the first year, 2% in the second year, and 1% in the third year; no prepayment penalties can be charged that extend beyond the first three years of the loan. Act §1414(a). However, it should be noted that HOEPA is both triggered by and prohibits all prepayment penalties that extend beyond three years or that are greater than 2% of the amount prepaid. Act §1431(a). As a practical matter, therefore, even qualified mortgages will be limited to charging 2% of the outstanding balance in the first year.

48 *See In re Ocwen Mortg. Servicing, LLC Mortg. Servicing Litigation*, 491 F.3d 638 (7th Cir. 2007).

49 *See, e.g.,* Smith v. Encore Credit Corp., 623 F. Supp. 2d 910, 920 (N.D. Ohio 2008).

50 HOEPA coverage is also triggered for manufactured housing (dwelling is personal property and the transaction is less than $50,000) and subordinate liens if the APR is more than 8.5 points above the APOR. Act §1431.

51 For transactions of less than $20,000, the trigger is the lesser of 8% or $1,000. Act §1431.

52 The "points and fees" definition now includes the maximum prepayment penalty on the loan, premiums for any credit life, disability, unemployment and property insurance not paid on a monthly basis (but these are already prohibited by the Act), and prepayment penalties incurred by the consumer if the loan refinances a previous loan made by or held by same creditor or affiliate of creditor. Act §1431(c).

53 HOEPA loans cannot contain prepayment penalties under 15 U.S.C. §1639(c). As a result, now prepayment penalties that extend beyond 36 months not only trigger HOEPA, they violate it. Act §1431.

54 The new phrase replaced the old phrase in 15 U.S.C. §1609(aa)(4)(B), which stated, "[Points and fees includes] all compensation paid to mortgage brokers."

55 Prior to the Act, the HOEPA points and fees trigger stated that a mortgage was a high-cost loan if "the total points and fees *payable by the consumer at or before closing* will exceed . . . 8 percent of the total loan amount." 15 U.S.C. §1609(aa)(1)(B) (emphasis added). Some argued that, even accepting the argument that consumers indirectly pay the YSP through a higher interest rate, they do not make that payment at or before closing. The Act clarifies the language to state that HOEPA is triggered if "the total points and fees *payable in connection with the transaction* . . . exceed . . . 5 percent of the total loan amount." Act §1431.

56 For example, if a lender originates a $100,000 loan with $5,000 in points and fees, that loan will both trigger and violate HOEPA if any of the points and fees are financed.

57 Pub. L. No. 111-24, 123 Stat. 1734 (2009).

58 *See* Rachel Beck, *All Business: Credit-Card rates up before new law*, ABC News, 10/31/09, available at http://abcnews.go.com/Business/wireStory?id=8962877; Liz Pulliam Weston, *Credit Card Lenders Go on a Rampage*, MSN Money, 11/25/09, available at http://articles.moneycentral.msn.com/Banking/YourCreditRating/weston-credit-card-lenders-go-on-a-rampage.aspx; *Significant APR Increases Took Place Before CARD Act*, 2/24/10, available at http://www.lowcards.com/2010/02/significant-apr-increases-took-place.html

59 *See, e.g.*, Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, Center for Responsible Lending, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis* (2010), *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf.

60 *See, e.g.*, *Ramirez v. Greenpoint Mortg. Funding Corp.*, 2010 WL 2867068 at *4 (N.D. Cal., July 20, 2010) (noting study by plaintiffs' expert Howell Jackson on racial disparities in loan terms); *Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A.*, 631 F. Supp. 2d 702 (D. Md. 2009).

61 *See, e.g.,* Linda Singer, *When States Are Shut Out,* Nat'l Law L.J., Jan. 5, 2009.

62 *See* Quester & Keest, *supra* page X, at 195-96 (noting that from 2000 to 2007, despite serious problems in the mortgage market, the OCC only took two enforcement actions against banks for unfair and deceptive practices).

63 See 12 CFR §560.2; §7.4000-7.4009; §34.4.

64 States can enforce both the Act and its own rules against any other entity (other than national banks or thrifts). The Act also expands state attorneys generals enforcement authority to additional sections under TILA. However, before a state sues a federally chartered bank, it must give notice to the Bureau and the bank's prudential regulator. The CFPB can intervene, remove the matter to federal court, and participate as any other party.

65 Under Dodd-Frank Act, defined as "a state law that does not…discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transactions." Act § 1044.

66 Aline van Duyn, "Rating Agencies Face Fresh Questions," Financial Times, 6/1/10, available at http://www.ft.com/cms/s/0/aa02a8f0-6db1-11df-b5c9-00144feabdc0.html.

67 Roger Lowenstein, "Triple-A Failure," The New York Times, 4/27/08, available at http://www.nytimes.com/2008/04/27/magazine/27Credit-t.html?_r=1&pagewanted=print.

68 Anusha Shrivastava, "Bond Sale? Don't Quote Us, Requests Credit Firms," *The Wall Street Journal*, 7/21/10, *available at* http://online.wsj.com/article/NA_WSJ_PUB:SB10001424052748704723604575379650414337676.html

69 See, e.g., People ex rel. Cuomo v. First Am. Corp., 878 N.Y.S. 2d 860, 862 (N.Y. Sup. 2009).

70 Sharon L. Lynch and Bob Ivry, "Appraiser Exposes Toxic Debt Tie to Inflated Values," *Bloomberg*, 1/17/08, *available at* http://www.bloomberg.com/apps/news?pid=21070001&sid=aKTGgOD1teG4; *See also* Sharon Lynch, "Fannie, Freddie cut Deal Over Home Appraisals," Washington Post, 12/24/10, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2008/12/23/AR2008122302431.html.

71 A "higher-risk mortgage" is defined as a residential mortgage loan that is not a qualified mortgage as defined in §1412 (§129C of TILA) with an interest rate that exceeds the APOR: (1) by 1.5 percentage points for a first lien residential mortgage loan, (2) by 2.5 percentage points for a jumbo loan, or (3) by 3.5 percentage points for a subordinate lien. Act §1471.

72 "The NPV is essentially an accounting calculation to determine whether it is more profitable to modify the loan or allow the loan to go into foreclosure. . . . The calculation compares the probability that the mortgage defaults and the estimated loss to the servicer given foreclosure with the cash flow generated if the loan is modified. . . . Servicers are permitted to customize the NPV model to fit their unique loan portfolios." *See Williams v. Timothy F. Geithner*, 2009 WL 3757380 at *3 n.3 (D. Minn. Nov. 9, 2009).