

QUARTERLY REPORT

MID-SOUTH REGULATORY COMPLIANCE GROUP

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CFPB ISSUES MORTGAGE ORIGATION GUIDANCE

The sleeping giant that is the Consumer Financial Protection Bureau (CFPB) has been awakened as a result of the recess appointment of Richard Cordray to be the CFPB's new Director. Many things have been on hold pending that appointment, and it is likely that the pace of new developments and new regulations will now accelerate. With the Director in place, the CFPB can set about regulating those entities that have not thus far been regulated and examined the way banks have been. Mortgage lending is one of the initial areas of interest.

Last week, the CFPB issued new Exam Procedures for Mortgage Origination. While the compliance function of mortgage loan origination has not been changed, the focus of these exam procedure has. The emphasis now is on protecting the consumer, rather than making sure that the lender uses all of the right forms, crosses all of the "t's" and dots all of the "i's." Banks that originate loans secured by a borrower's residence will be covered, as will the previously less regulated mortgage companies.

An examination of these new Guidelines reveals a number of things.

First, CFPB has identified residential mortgage lending, all lenders and all products, as a primary area of focus. That is not surprising given the subprime mortgage crisis of only a few years ago, the underwriting deficiencies that were allowed to take place, the resulting foreclosure rate for residential mortgages, and the severe impact all of that had, and is having, on the American consumer.

In response to the foregoing problems, and as result of demands from an angry Congress and U.S. citizenry, the Federal Reserve, the Department of Housing and Urban Development, and other regulatory agencies enacted a number of changes aimed at better protecting consumers. But those late responses were not enough. The power to write and enforce those consumer protection regulations was stripped away and given to the CFPB. The CFPB's reaction has been predictable, and even may be beneficial.

The laws and regulations that relate to mortgage lending have been on the books for 35 or more years. They have been amended from time to time, but always with the same regulatory mindset. Now the CFPB has taken the reins and not surprisingly they have shaken things up.

Where in the past the bank regulators have looked at the consumer protection laws and regulations in much the same way that banks have, now the CFPB is taking a new and "holistic" approach. They are no longer just looking at TILA requirements as a disclosure issue, RESPA requirements as a loan closing issue, and Fair Lending as a possible

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discriminatory loan underwriting or loan pricing issue. Instead, they are attempting to look at the entire process of obtaining mortgage loan financing (first lien, second lien, home equity, etc.) as it relates to the consumer and the protection of consumers in all areas. In some ways this new, fresh look may be a good thing.

These new exam procedures list the following exam objectives:

- To assess the quality of a bank's compliance management system and its mortgage origination business;
- To identify acts or practices that materially increase the risk of violations of federal consumer financial laws, and associated harm to consumers, in connection with mortgage origination;
- To gather facts that help determine whether a bank engages in actual practices that are likely to violate consumer financial laws in connection with mortgage origination; and
- To determine whether a violation of a federal consumer financial law has occurred and whether further supervisory or enforcement action would be appropriate.

The new procedures then list seven different Modules to be reviewed:

- Module 1 -- Company Business Model.
- Module 2 -- Advertising and Marketing.
- Module 3 -- Loan Disclosures and Terms.
- Module 4 -- Underwriting, Appraisals and Originator Compensation.
- Module 5 -- Closing.
- Module 6 -- Fair Lending.

- Module 7 -- Privacy.

Let's look briefly at each of these Modules.

Company Business Model. This first Module requires examiners to interview the managers of a bank's various real estate lending areas to gather information regarding the different channel(s) by which the bank makes or acquires mortgage loans (retail operations, broker relationships, wholesale or correspondent relationships, etc.). Examiners will then gather details about the compliance management system in place to assure that each of these channels is compliant with consumer protection laws and regulations when it originates mortgage loans. Each channel will be reviewed for the products that it offers, the audit, underwriting and appraisal practices in place. Compensation arrangements and training for staff will also be reviewed.

Advertising and Marketing. Examiners will review all marketing and advertising materials for compliance with the requirements of Regulation Z (TILA), RESPA, the Equal Credit Opportunity Act (Regulation B), and the SAFE Act registration requirements. This component of the exam procedures has a heavy UDAAP feature to it, looking for any information given to a consumer that could be false, misleading or just confusing.

Loan Disclosures and Terms. At this stage, examiners will look at the bank's practices and procedures and do sample testing of the various loan products. This Module looks a lot like the traditional compliance exam function. Portions of the Module also deal with Regulation Z (TILA) RESPA, ECOA (Regulation B), and the Fair Credit Reporting Act disclosure requirements. Again, it may be refreshing to see all of these disclosure requirements reviewed in an organized and holistic way, rather than as parts of several different regulations.

Underwriting, Appraisals and Originator Compensation. This Module goes hand in hand with the Module 6 Fair Lending Module. It looks at loan underwriting practices, procedures and policies. It looks at recent changes to TILA and Regulation Z as they relate to the requirement to determine a borrower's ability to repay. It looks to compensation of mortgage loan originators and any influence sale or production units might have on a mortgage loan originator's independence. Any subprime or non-traditional loan products or programs will be reviewed. Issues of steering customers to less favorable or more expensive products are also taken into account. Issues related to appraiser independence (Regulation Z) and furnishing appraisal information to consumers (Regulation B) are also covered.

Closing. Procedures and practices for complying with RESPA and TILA (Regulation Z) disclosure requirements will be reviewed.

Fair Lending. Fair Lending will always be a key issue. At this stage, HMDA data reporting requirements will be examined, and in most instances a regression analysis will be performed to look for patterns of discrimination.

Privacy. This final Module looks at the privacy and information sharing requirements under the Gramm-Leach-Bliley Act and Regulation P.

In summary, this is a new and more efficient way of looking at a number of traditional compliance requirements. It emphasizes all of the recent changes to regulations that have been made to protect consumers. And it looks at issues (e.g., business models, compensation arrangements, etc.) that have not traditionally been reviewed.

We will cover these new exam procedures in greater detail at the February meeting. That review will serve as a refresher on the various

changes we have discussed from time to time at other Quarterly Meetings.

(Ed Wilmesherr)

FOCUS GROUP TO AID WITH COMPLIANCE

Over the last three years, and particularly since the enactment of the Dodd-Frank Act, a great deal has been written and said about the increased burden that will be placed upon compliance officers and banks of all sizes. As is too often the case, speculation has not led to much in the way of action. And it is abundantly clear that affordable help is needed.

At the Annual Meeting of the MRCG and MSRCG, we outlined a vision for a plan to provide just such help. We called for a Focus Group of the combined MRCG/MSRCG that would examine ways that the members of the two groups could pool their strengths and resources to gain the extra measure of help that is needed to cope with the growing burden of compliance, while allowing each member to only incur a small cost due to the cost-sharing power of 80 banks.

As you read this article, the Focus Group is in the process of meeting. A substantial number of members of both groups will meet February 1, 2012 in both Butler Snow's Ridgeland and Memphis offices to brainstorm about the things we can do to make a compliance officer's or a bank president's life easier and more manageable. Among the things we plan to discuss are an overall Compliance Risk Assessment and a targeted Risk Assessment for Unfair and Deceptive Acts or Abusive Practices. (These are two new areas of compliance that examiners are currently stressing.) Training, a burden that every bank faces, is another area that will be considered. And a systematic way to quickly and affordably help a bank's management and its board of directors stay informed regarding

changes and developments in banking laws and regulations is yet another possibility.

We plan to take the results of this Focus Group meeting and present it to the membership as a whole at the upcoming February meeting in hopes of getting off to a fast start in implementing this much needed help. Please bring your thoughts and ideas to the February meeting.

(Ed Wilmesherr)

FAIR LENDING: A \$335 MILLION EXAMPLE

To get a good idea of your regulators' focus on fair lending, consider Countrywide. On December 28 of last year, a federal court in California approved a settlement of fair lending claims made by the Department of Justice against Countrywide, requiring Countrywide and its affiliates to pay \$335 million to compensate discrimination victims and to fund organizations that provide credit counseling, financial literacy, and other similar programs targeted at African-American and Hispanic potential and former homeowners. The agreement marks the largest residential fair lending settlement in history.

According to the Department of Justice, from 2004 until Countrywide's 2008 sale to Bank of America, Countrywide discriminated against its loan customers on the basis of race, ethnicity, and marital status. Specifically, the complaint alleged, in part, that:

- More than 200,000 Hispanic and African-American borrowers paid higher loan fees and costs for their home mortgages than non-Hispanic White borrowers, not based on their creditworthiness or other objective criteria related to borrower risk, but because of their race or national origin;

- Hispanic and African-American borrowers were placed into subprime loans when similarly-situated non-Hispanic White borrowers received prime loans, not based on their creditworthiness or other objective criteria related to borrower risk, but because of their race or national origin; and
- Countrywide encouraged married borrowers applying for credit in one spouse's name to have their non-applicant spouses give up all their rights and interests in the property securing the loan at the time the loans were originated.

The numerous allegations largely focused on Countrywide's grant of subjective authority in loan origination to loan officers and mortgage brokers. In particular, the 43 page complaint alleged that Countrywide allowed its employees and mortgage brokers to set loan prices and to place borrowers into loan products in ways that were not connected to creditworthiness or other objective risk criteria, and these subjective pricing methods resulted in higher rates for African-American and Hispanic borrowers in violation of fair lending standards that Countrywide knew or should have known about based on its internal monitoring and reporting.

For example, Justice specifically pointed to Countrywide's two-step method of pricing loans: an initial objective pricing model followed by subjective pricing by loan officers. Operationally, Countrywide created internal interest rate sheets that determined par interest rates for different loan products based upon objective creditworthiness. These sheets stated a par interest rate for a particular credit risk in a particular loan product as well as floor and ceiling interest rates the lender would accept. For any particular loan application, the lender allowed loan officers to negotiate above or below the objective par interest rate subject to the stated caps. No written policies existed for increasing or

decreasing a particular applicant's rate within the pre-determined range of rates, and no operational system oversaw documentation or supervisory review of these rate adjustments. Further, retail loan officers were partially compensated based upon their personal loan volume with particular financial incentives tied to that officer's upward or downward deviation from the objective par rates. According to the Department of Justice, the par rates were generally higher than a competitor might offer for a comparable loan so most Countrywide customers were offered rates below par, although the complaint alleged that this practice further encouraged subjective pricing since most loans were not expected to be priced at par.

Critics have howled since the settlement, complaining that Justice's statistics are flawed. In a column entitled "Racism is Everywhere...Statistically," Wall Street Journal columnist Holman Jenkins argued that Countrywide's practices closely follow a car dealer's advertising a high retail price while few buyers actually pay full price; instead, prices actually paid are based upon individual negotiations at the dealer's lot. Further, the columnist noted, Justice ignored Non-Hispanic White borrowers who paid higher rates as well as African-American and Hispanic borrowers who paid lower rates, focusing only on those minority borrowers who paid higher rates. Note, however, that Countrywide and Bank of America voluntarily settled the matter on these terms while denying Justice's complaints of discrimination.

Countrywide's settlement provides a valuable example of regulatory focus on fair lending enforcement. In assessing fair lending compliance, banks should consider Countrywide's example to make certain that adequate proactive and reactive policies and controls exist for loan officers with discretionary authority in setting fees and rates.

(Jeff Stancill)

ODP PANEL DISCUSSION

Banks and Compliance Officers are still struggling with the details of Overdraft Protection Program compliance in light of last year's ODP Guidance from the bank regulators. Even the examiners apparently have their own struggles. Questions seem to abound.

A panel of Butler Snow and MSRCG member banks will conduct a discussion and Q&A regarding ODP compliance issues at the February Quarterly meeting. This should afford a good opportunity to present your questions regarding your bank's handling of its ODP program. Please give this topic some thought and forward your question(s) to patsy.parkin@butlersnow.com. Hopefully the panel will be able to answer.

(Patsy Parkin)

MSRCG QUARTERLY MEETING TO BE HELD ON FEBRUARY 28, 2012

The MSRCG will hold its February Quarterly Meeting on February 28, 2012, at The Racquet Club of Memphis in the Large Ballroom located at 5111 Sanderlin Avenue, Memphis, Tennessee. Registration will begin at 9:00 a.m. with the Quarterly Meeting to begin at 9:30 a.m. During the February Meeting, we will discuss the results of the joint MRCG/MSRCG Focus Group meeting and suggested next steps. We will also hold a panel discussion related to the problems and questions arising in connection with the administration of automated and ad hoc overdraft protection programs. The new CFPB Exam Procedures for Mortgage Loan Origination will be covered, and a summary of recent Fair Lending developments will be provided. As always, the dress code for this occasion is casual, and lunch will be provided. We ask that you fax or e-mail your registration to Liz Crabtree no later than **Wednesday, February 22, 2012** so that arrangements for lunch can be finalized. We look forward to seeing you there.

(Ed Wilmesherr)

MSRCG COMPLIANCE CALENDAR

01/16/09 – RESPA Servicing Transfer Disclosure revised	08/22/10 – Reg. E rules on gift certificates and gift cards effective
07/30/09 – Reg. Z early disclosures for dwelling secured loans effective	10/01/10 – Escrow requirements effective for mobile homes
08/20/09 – Reg. Z changes on time to make payments on open-end accounts effective	10/01/10 S.A.F.E. Act regulations effective
08/20/09 – Reg. Z changes on notices of changes in terms on credit card accounts effective	01/01/11 – Risk-Based Pricing Rules Effective
10/01/09 – Reg. Z higher priced mortgage loan regulations effective	01/31/11 – S.A.F.E. Act Registration Begins
10/01/09 – Reg. Z servicing practices regulations effective	02/28/11 – Post revised notice to IOLTA customers
10/01/09 – Reg. dwelling secured advertising disclosures changes effective	4/01/11 – Appraisal Independence Final Rule Effective
10/01/09 – HMDA changes for reporting rate spreads on higher priced mortgage loans effective	06/10/11 – Risk Retention Rule Comments Due
10/01/09 – Reg. Z HOEPA changes on verification of repayment ability effective	07/21/11 – Anticipated Effective Date for changes to Risk-based pricing notices
11/20/09 – Reg. Z disclosures on transfer of mortgage loans effective	07/22/11 – Ability-to-Repay proposed rule comments due
01/01/10 – RESPA GFE and HUD-1 disclosure changes effective	07/29/11 – S.A.F.E. Act Registration Expires
01/01/10 – Reg. DD changes on disclosure of OD fees and providing balance information effective	02/28/12 – MSRCG February Quarterly Meeting
02/14/10 – Reg. Z disclosures on private education loans effective	04/24/12 – MSRCG Steering Committee Meeting
02/22/10 – Reg. Z implementing changes to open-end credit and credit card accounts under Credit Card Act effective	05/22/12 – MSRCG May Quarterly Meeting
02/27/10 – Reg. CC disclosure changes effective	07/24/12 – MSRCG Steering Committee Meeting
04/01/10 – Escrow requirements effective for site-built homes	08/28/12 – MSRCG August Quarterly Meeting
06/01/10 – Unlawful internet gambling enforcement regulation compliance date	09/25/12 – MSRCG Steering Committee Meeting
07/01/10 – Reg. E changes for ATM and Debit Card Overdrafts	11/13/12 – MSRCG Annual Meeting
07/01/10 – FFIEC Accuracy and Integrity Guidelines effective	