GAME OF HOMES:
LITIGATING UNDER THE CFPB MORTGAGE ORIGINATION AND SERVICING RULES

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TABLE OF CONTENTS

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I. INTRODUCTION

Congress passed the Dodd-Frank Wall Street and Consumer Protection Act (the "Dodd-Frank Act") in response to the financial crisis of 2008 and 2009. In passing the act, Congress authorized the creation of the Consumer Financial Protection Bureau ("CFPB"), which is a newly formed government agency charged with, among other things, reformation and regulation of the mortgage loan industry. Indeed, a great deal of the financial regulatory change that has come out of the CFPB since its activation in 2011 is focused on mortgage loans, in part because of the strong perception during the financial crisis that lack of regulation, specifically that feeding into the subprime mortgage loan problem, had been a direct and large contributor to the collapse of the economy. Certainly, it was a direct cause of the deflation of the residential home market and accompanying foreclosure crisis.

The CFPB was given primary regulatory authority to implement the Truth in Lending Act ("TILA") and the Real Estate Settlement Procedures Act ("RESPA"). Under this authority, the CFPB issues mortgage servicing and origination rules promulgated under Regulation Z and Regulation X, respectively. These rules, and particularly the versions of them that became effective quite recently in January 2014, are often the source of litigation between borrowers and lenders. This article will examine some of the most frequent causes of action under both TILA and RESPA, explain the purposes of the rules and how they work, and then give readers practical tips from both a plaintiff lawyer's and a defense lawyer's perspective on how to litigate effectively under these rules whether your client is a borrower or a lender.

II. THE MOST RELEVANT CFPB SERVICING RULES AND CLAIMS UNDER RESPA

The Real Estate Settlement Procedures Act, contained in 12 U.S.C. §§ 2601 *et seq.*, was originally enacted in 1974 as a response to what some perceived as unscrupulous behavior by actors within the mortgage lending industry. Many different players within the industry, including lenders, real estate brokers, and title insurance companies, were accused of driving up costs for borrowers and supplying kickbacks to one another. In response, Congress enacted RESPA to formulate strict rules and prohibitions on how mortgage loan documents could be closed and serviced. The purpose was to streamline settlement of real estate transactions and make the associated costs more transparent to borrowers, thereby increasing the efficacy and competitiveness within the industry.

RESPA has been administered by the Consumer Financial Protection Bureau (CFPB) since July 21, 2011, one year after the Dodd-Frank Act created the CFPB. It is administered by the CFPB through Regulation X, which promulgates rules regarding many aspects of mortgage servicing. This section discusses two of the most commonly litigated claims under RESPA, followed by a discussion of some of the procedural hurdles to prevailing on a RESPA claim. Some RESPA causes of action can be utilized in the foreclosure context as well as litigated as stand-alone claims.

A. Loss Mitigation Applications

Prior to the CFPB's overhaul of RESPA (and TILA) in 2014, borrowers commonly ran into a practice known in the industry as "dual tracking." Dual tracking occurred when borrowers thought they were working with their servicer on a loan modification agreement to bring their delinquent mortgage loan current, only to find out that the lender or servicer had been simultaneously initiating foreclosure proceedings. This was incredibly frustrating to borrowers. And, surprisingly, this was also sometimes frustrating to lenders and servicers, since it was often a case of "the right hand doesn't know what the left hand is doing." In the case of very large, high-volume servicers with multiple departments, it was entirely possible for one department to be working earnestly with a borrower on loan modification while another department, unbeknownst to the first, was working toward foreclosure on the same loan account.

In early 2014, new rules were promulgated under RESPA in order to prohibit dual tracking. Now, under 12 C.F.R. § 1024.41, if a servicer receives a completed loss mitigation application from a borrower more than thirty-seven days before a scheduled foreclosure sale, in most circumstances the servicer and lender cannot move for a foreclosure order or foreclosure sale until the borrower has been notified whether his or her application has been approved or denied. If the application is approved, then no foreclosure sale will occur. If the application is denied, the borrower has a right to appeal under the process outlined in 12 CFR § 1024.41(h). During the pendency of the appeal, the servicer and lender cannot move forward with foreclosure.

PLAINTIFF PRACTICE TIP. This prohibition applies even if the foreclosure process has started, so long as the application was submitted at least thirty-seven days prior to the scheduled foreclosure sale. Defendant is expressly prohibited by RESPA from either pursuing judicial foreclosure or foreclosing under the power of sale within a deed of trust until the completion of any appeal, or, alternatively, until the borrower rejects an offered loan modification or fails under the terms of one. This prohibition on foreclosure can act as either a defense to foreclosure or a stand-alone claim, actionable pursuant to section 12 U.S.C. § 2605(f), which also allows for the recovery of actual damages, statutory damages of up to $2,000, court costs, and attorney's fees.

DEFENDANT PRACTICE TIP. If a borrower submits a *completed* loss mitigation application within thirty-seven days of the foreclosure date, the prohibition will not apply. Whether an application was "complete" is the key to successfully defending these claims. Further, be careful—if a foreclosure prohibition is in place as a result of an application for modification, the servicer cannot simply reschedule the foreclosure more than thirty-seven days out. In order to comply with the statute, foreclosure is effectively stayed until the borrower has worked their way through the appeal process or a loss mitigation has been worked out and foreclosure is no longer necessary.

Also, if loss mitigation options are offered but the borrower refuses all of them, the servicer can then proceed with foreclosure. Likewise, if there is a loss mitigation put into place, such as a three month Trial Payment Plan (TPP), yet the borrower fails to fulfill their obligations under that plan, the foreclosure can proceed upon the borrower's default. As to what constitutes default under a TPP, that is not well-settled, but it is probably safe to say that once a borrower has missed a payment under the TPP and fifteen days have passed since the due date, the lender has a good argument that the borrower has defaulted under the TPP. Always check case law for the latest holdings in the jurisdiction your case is in to see if there is applicable precedent, which is especially important in the case of regulatory rules as recent as this one. Perhaps most important to remember, and to point out to the servicer, is that nothing in the statute or regulations require the lender or servicer to offer any *specific* loss mitigation option, or any at all if the borrower simply does not qualify.

B. Request for Information and Notice of Error

When RESPA was updated in January of 2014, the previous, more general use of "qualified written request" was essentially divided by reference into two specific types of requests, detailed in 12 U.S.C. § 2605(e):

1) a request for information, and
2) a notice of error.

The timelines to respond to requests for information and notices of error were specified slightly differently, as well. Generally speaking, requests or notices must be acknowledged within five days and responded to within thirty days. However, servicers can take up to forty-five days to conduct an investigation into a notice of error, if necessary, within which time they must either correct the error and provide the borrower with written notification of such, or conclude that no error occurred and, again, provide the borrower with written notice. During the sixty days leading out from the borrower's request, servicers are specifically prohibited from reporting negative information to the credit bureaus regarding overdue payments related to the request.

RESPA requires servicers to meet certain procedural requirements, in addition to the timelines, for responding to requests for information or notices of error. In addition to errors that RESPA specifically lists, there is a catch-all for any errors relating to the servicing of a mortgage loan. More specifics on requirements for responses can be found under 12 U.S.C. § 2605(e), along with more details on the timelines for the two particular types of requests.

PLAINTIFF PRACTICE TIP. Under 12 U.S.C. § 2605(f), borrowers can obtain actual damages and, if they can show a pattern or practice of violations by the servicer, an additional statutory amount not exceeding $2,000. There is no statutory presumption that notices are responded to, and the burden will generally fall upon the client to show proof they have submitted a written request or notice by email, facsimile, or U.S. postal mail. Then, the burden will shift to the servicer to show that the servicer responded.

DEFENDANT PRACTICE TIP. This issue will almost always boil down to documentation, for better or for worse, except in cases where the adequacy of the response is called into question. The servicer should be asked to compile all appropriate documentation showing what responses were given, by whom, and when. Due to the new and very short timelines for acknowledgment and response to the two types of written requests, those representing lenders on a regular basis need to be sure to advise clients to have a renewed emphasis on responding to these requests and documenting well. Although the actual damages requirement, particularly when interpreted by the courts as a pecuniary prerequisite, do bar many otherwise potential claims, the timelines and the strict statutory requirements have the potential to generate lots of litigation against lenders who do not practice careful record keeping.

C. Proving Up a RESPA Claim

There is precedent by the Northern District of Texas that damages under RESPA must be both actual and pecuniary. *Steele v. Quantum Servicing Corp.*, 3:12–CV–2897–L, 2013 WL 3196544 (N.D.Tex. June 25, 2013). In that jurisdiction, therefore, there is an increased burden upon the plaintiff to show that he or she has suffered tangible financial loss. It may be enough to show that loss of credit opportunity was a result of the violations, however, loss of credit opportunity is often dismissed by the courts as speculative unless the plaintiff is able to offer some evidence of denied credit that likely would not have been denied if not for a drop in credit rating. That drop in credit rating, in turn, must be plausibly caused by the RESPA violation.

The Western District of Texas has also chimed in on the subject of what constitutes actual damages. In *Trahan v. GMAC Mortg. Corp.*, the court concluded that mental anguish damages cannot constitute sufficient damages alone to satisfy the actual damages requirement in RESPA. *Trahan v. GMAC Mortg. Corp.*, No. EP–05–CA–0017–FM, 2006 WL 5249733, at *8 (W.D.Tex. July 21, 2006). The holdings in both *Steele* and *Trahan* prevent a plaintiff (at least in those jurisdictions) from being awarded statutory damages, as well, unless the plaintiff can prove actual and pecuniary damages on which to base the additional statutory damages. Not all jurisdictions have ruled on whether actual means actual and pecuniary, but it seems more likely than not that when the issue comes up, other Texas jurisdictions will concur with the Northern and Western Districts.

Requests for information and notices of error apply only to “federally related mortgage loans” as that term is defined in 12 C.F.R. § 1024.2(b). These are loans made by any lender (a) whose deposits or accounts are insured by any agency of the federal government, (b) whose loans are intended to be sold to any of the GSEs (the Government Sponsored Entities, such as Freddie Mac or Fannie Mae), or (c) who makes or invests in residential real estate loans aggregating $1,000,000 or more per year. The CFPB has not, to the authors’ knowledge, provided an official, written interpretation as to whether the category regarding loans made by a lender whose deposits or accounts are insured by any agency of the federal government captures smaller lenders whose bank accounts are federally insured (as most are) or has a different meaning. Assuming that the most likely meaning is just that, this is a catch-all that swallows almost all conceivable lenders.

III. THE MOST RELEVANT CFPB ORIGINATION RULES AND CLAIMS UNDER TILA

Congress enacted the Truth in Lending Act (TILA), contained in 15 U.S.C. §§ 1601 *et seq.*, in 1968 with the goal of enhancing economic stability and increasing competition among consumer credit providers. To achieve this goal, TILA aimed to institute rules and procedures that would boost consumers’ awareness of fees and costs associated with credit, by imposing rules and limitations upon the lenders of such credit as to how they could market and explain the terms to consumers.

One credit-based industry that is hugely affected by TILA is the mortgage industry. TILA requires that lenders of residential loans secured by consumers’ homes provide specific disclosures, and today’s TILA even allows for rescission of certain loans in certain circumstances when those disclosures are not properly given. The CFPB was given general rulemaking authority for the majority of TILA in July 2011, when the CFPB became “active” one year after its inception as part of the Dodd-Frank Act was enacted on July 21, 2010. Under 15 U.S.C. § 1601 and in accordance with the Dodd-Frank Act, the CFPB interprets TILA through Regulation Z, in which it promulgates regulatory rules for the mortgage industry. Several of these rules are frequently litigated, either in the foreclosure context or as stand-alone claims.

This section discusses three of the most commonly litigated CFPB origination rules: ability to repay (ATR) claims, disclosures, and periodic statements. The ATR rules have a host of requirements, but also a great many exceptions, and the authors recommend reading them closely. Loan origination disclosure requirements will be updated by the CFPB later this year, but most aspects will remain the same. The requirement for periodic billing statements applies only to closed-end mortgage loans. This means, notably, that open-ended loans, such as reverse mortgage transactions and home equity lines of credit (HELOC), do not fall within the purview of the requirement.

A. Ability to Repay (ATR) Claims

The new ability to repay (“ATR”) rules apply to new transactions and to assumptions. Assumptions are defined by Regulation Z in 12 C.F.R. § 1026.20(b). Under the heading of Minimum Standards for Transactions Secured by a Dwelling, Regulation Z lays out guidelines requiring a creditor to make a reasonable and good faith determination that the consumer has the ability to repay at or before consummation of the covered transaction. No creditor may make a residential mortgage loan unless the creditor “makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes [and] insurance….” 15 U.S.C. § 1639c(a)(1).

What about successors-in-interest? Death and divorce in the context of successors-in-interest can be found under 12 C.F.R. § 1026.43(c). In addition, the CFPB frequently comes out with official interpretations to clarify the new regulations. In a CFPB Official Interpretation dated July 17, 2014, the CFPB clarified that the ATR Rule does not apply to a transaction in which a successor seeks to take on the debt secured by property that the successor previously acquired. This applies to situations such as death of a parent and inheritance of a dwelling, or partition of property in accordance with a divorce.

PLAINTIFF PRACTICE TIP. See 12 C.F.R. § 1026.43(c)(2) for a helpful list of things that a lender *must* consider to be compliant with ATR, including the consumer's current or reasonably expected income or assets, the monthly payment on the transaction in question, other monthly obligations, credit history, and several other considerations.

DEFENDANT PRACTICE TIP. ATR requirements do not apply to many situations and loans, including construction, bridge, or reverse mortgage transactions. It’s best to consult 12 C.F.R. § 1026.43(a), the scope of the regulation, to see what exceptions, if any, apply to your client’s loan.

B. Loan Origination Disclosures

TILA generally requires creditors to provide disclosures to consumers before consummation of many closed-end loans. The content required of these disclosures can be found enumerated under 12 C.F.R. § 1026.18, with more rules specific to mortgage-related loans found under 12 C.F.R. § 1026.19. Attorneys can look to 15 U.S.C. § 1635 for specifics on the right to rescission held by borrowers who do not receive these prescribed disclosures in a timely manner. TILA grants a borrower the right to rescind a loan transaction, “until midnight of the third business day following the consummation of the transaction or the delivery of the [disclosures with required information and rescission right notices], whichever is later, by notifying the creditor, in accordance with regulations of the Bureau, of his intention to do so.” 15 U.S.C. § 1635(a). However, there are several exceptions to which the right of rescission do not apply, such as purchase money loans and refinancing or consolidation with the same lender where no new funds are advanced. Notably, refinancing a purchase money loan with a *new* lender does qualify.

This spells out a three-day right to rescission when disclosures are given. However, if the creditor fails to provide the requisite TILA disclosures at all, a borrower may rescind the transaction for up to three years from the date the loan closed. Three years acts as an outside limit on the time that borrowers can exercise their rescission rights, to prevent the possibility of never-ending liability for the lender. 15 U.S.C. § 1635(f).

The right of rescission exists for certain non-purchase money loans, which means that purchase money loans such as original funds for a mortgage cannot be rescinded. Until very recently there has been a split in the courts on a national basis as to whether the right to rescission was exercised upon commencing litigation or upon notification by the borrower to the lender of the borrower’s intention to rescind. This issue was put to rest by the United States Supreme Court in *Jesinoski v. Countrywide Home Loans, Inc.*, in January of 2015. *Jesinoski v. Countrywide Home Loans*, *Inc.*, 574 U.S. ——, 135 S.Ct. 790, 190 L.Ed.2d 650 (2015). The Supreme Court opinion in *Jesinoski* sets the record straight on exercising the right of rescission. Only notification, not litigation, is needed to bring a timely rescission.

In the *Jesinoski* case, as in others before it, the borrowers notified their lender in writing of their intent to rescind their loan transaction within the three-year window, but did not bring suit against their lender until after the three years had passed. The question is a simple one, but with significant repercussions, especially for lenders, who can lose not just their security interest but also significant money in the form of returned fees, down payments, and (in some cases and jurisdictions) even principal. Many courts, including the Court of Appeals for the Eighth Circuit, which the Supreme Court overruled with this decision, had held that litigation was the only way to initiate rescission and that if litigation was not commenced within that window then the borrower had lost his or her right to rescind.

The *Jesinoski* decision clarifies the rule on exercising rescission, but other, related guidelines will have to be worked out in the Fifth Circuit, and across the country in the lower courts. For instance, how soon must a lawsuit be filed after the right is exercised? How will an effected rescission affect the status of a mortgage lien, and how soon? Must a plaintiff who effectively gives a rescission notice tender all loan proceeds prior to receiving back funds paid to the lender and the security interest previously given? That has frequently been the case in the past, but might be reconsidered as a result of *Jesinoski*. On the heels of clarification come a slew of related questions.

PLAINTIFF PRACTICE TIP. In addition to not receiving any purported disclosures at all (which is conceivable) the right of rescission applies when the disclosures do not conform to statutory requirements. Particularly, in 15 U.S. Code § 1635(i)(2) you will find the tolerance for understating finance and other charges in the disclosures. The disclosed amount may not differ by more than $35 less than the true amount. Anything within that limit is considered accurate for purposes of the disclosures, as well as overstating the amount. The right to rescission can also work as a defense to foreclosure, as provided by 15 U.S. Code § 1635(i), allowing a borrower facing foreclosure to explore whether there are any defects in the notices given and, if so, immediately exercise rescission to stop a foreclosure. The private right of action is contained within 15 U.S. Code § 1640, and borrowers can obtain actual damages, statutory damages up to $4,000, court costs, and attorney's fees.

DEFENDANT PRACTICE TIP. First, know that there is a presumption of delivery of the required disclosures if your client can show that the borrower signed that he or she received them. However, know also that it is a rebuttable presumption and not an absolute one. If the client might be able to provide documentation that shows that the borrower acknowledged receipt of the disclosures, if actual receipt is at issue, that documentation should be requested as soon as possible. If there continues to be uncertainty in the courts as to whether the borrower must refund the loan proceeds prior to or simultaneously with the lender's relinquishment of funds paid plus security interest, this can be used as leverage to negotiate an acceptable outcome without the need for continued litigation. If rescission is successful, the client is left without a security interest, but is still able to sue upon the note.

C. Requirement for Periodic Statements.

The basic requirements for periodic statements can be found in 15 U.S.C. § 1638(f), and the CFPB has issued requirements in greater detail in 12 C.F.R. § 1026.41. The most general requirement is that the creditor, assignee, or servicer of any residential mortgage loan must send the consumer a periodic statement each billing cycle setting forth particular information in a conspicuous and prominent manner. All the required information is listed within 15 U.S.C. § 1638(f), but included in the requirements are the following: the amount of the principal obligation, the current interest rate, a description of late payment fees, and a telephone number and email address that the obligor can use to obtain information regarding the loan.

The periodic statements requirement does have some exceptions. In addition to only being applicable to closed-end loans, as noted earlier, the periodic statement requirement exempts small servicers. A small servicer, for the purposes of this requirement, is a servicer that services 5,000 mortgage loans or less and that only services loans that the servicer (or an affiliate) owns or originated. Thus, the so-called "small servicer" must also be the originating lender and/or current owner of the loan and, additionally, service 5,000 or less loans at any given time. Additionally, any Housing Finance Agency (HFA) also enjoys an exemption from the periodic statements requirement, as well as other TILA requirements, and this is true without regard for the number of loans the HFA services at any given time. There is also an exemption for fixed-rate loans in which the coupon book given to the consumer contains substantially the same information as would be required in the periodic statements. Other exemptions can be found under 12 C.F.R. § 1026.41.

PLAINTIFF PRACTICE TIP. As a practical matter, when evaluating a plaintiff's potential case, just be aware of these exemptions and, if the potential defendant is determined to fall within the small servicer guidelines, be aware that the claim cannot be successfully brought against them. However, it is sometimes the case that whether or not a servicer falls within this exemption from the periodic statements requirement cannot be determined at the outset. Defendants may claim the exemption without proof, and discovery may be necessary to validate or disprove their small servicer claim. Importantly, the servicing of just a *single* loan that is not actually held by the defendant (or an affiliate) is sufficient to invalidate the exemption as to *all* of their loans. The periodic statement requirement is actionable pursuant to 15 U.S.C. § 1640(a)(2)(A)(iv), with statutory damages of no less than $400 and no more than $4,000. Furthermore, violations are stackable, and it can be the case that sometimes servicers neglect to send periodic statements for multiple months in a row, each violation of which is actionable.

DEFENDANT PRACTICE TIP. If your client has sent periodic statements complying with the required information under 15 U.S.C. § 1638(f) and 12 C.F.R. § 1026.41, and has retained copies and/or proof of such, providing it to the plaintiff's counsel at the outset may mean the claim is simply dropped. Sometimes, if they insist on proceeding with the claim, you will need to introduce into evidence the proof that statements were timely sent and that they complied with the TILA requirements. If you find that the client has indeed neglected to send statements, or at the outset there is no proof to be given, look for any exemptions that the client may fall under, including type of loan, whether a coupon book was provided to the borrower, or whether they fall into the small servicer category.

IV. CONCLUSION

With the newly promulgated requirements under Regulations X and Z still less than two years old, we are bound to see a great deal of litigation under the mortgage servicing and origination rules for years to come. This will be particularly true as the individual jurisdictions work out their individual bodies of law under cases of first impression, and more cases will present for the first time as the CFPB continues to both promulgate new rules in the future and tweak the rules already in place. This article provides only the briefest overview of some of the many rules, and while the authors hope it will be of some help to attorneys on both sides of the table, they strongly encourage readers to read the statutes and regulations for themselves, taking particular care in regards to the many requirements and exemptions to each rule, not all of which were able to be covered in a single article.