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Combating Current Legal Threats

Tips for Mortgage Lenders and Servicers

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CURRENT LEGAL THREATS

Three key threats that have emerged since the beginning of the pandemic that impact California mortgage lenders and servicers are: (1) fair servicing issues, (2) fair lending issues and (3) the unknown effect of the revamped Department of Business Oversight ("DBO").

FAIR SERVICING ISSUES

We started the pandemic with servicers continuing to adhere to a vast number of federal and state laws and regulatory guidance, including the Mortgage Servicing Rules[1] and fair lending laws designed to protect against disparate *treatment* and disparate *impact*.[2] The fair servicing focus has been seen in consent orders issued by the Consumer Financial Protection Bureau ("CFPB"), examination guidance, and scrutiny on whether loan modification and loss mitigation options are provided at a statistically lower rate to protected class borrowers versus other borrowers.

The CARES Act and further regulatory guidance from the CFPB changed the landscape for default servicing with restrictions on foreclosures, new forbearance requirements, and revised credit reporting procedures, among other changes. The CFPB jointly with other regulators have encouraged financial institutions to extend accommodations to consumers and stated that "prudent efforts that are consistent with safe and sound lending practices should not be subject to examiner criticism."[3] However, such accommodations may inadvertently result in differential treatment of borrowers. Servicers should also be mindful that consumers continue to have a private right of action under the Federal Debt Collections Practices Act that permits recovery of actual damages, statutory damages, and attorneys' fees and costs.[4]

MAINTAINING FAIR SERVICING

A servicer can best maintain compliance with the new requirements and avoid triggering fair lending issues by developing a process to mitigate this risk that includes the following:

- **Identification of known risks** such as payment processing, late fees, disparate offering of loss mitigation options; failure to provide loan ownership transfer disclosures, permitted repayment options in annual escrow statements, or providing consumers in bankruptcy with periodic statements; timely refunding forced placed insurance charges for overlapping coverage; etc.
- **Evaluation of your current environment** of increased servicing volume, increased complaints, staff working remotely, availability of additional skilled staff, ability to train, implementation of regulatory changes, etc.
- **Evaluation of your current capabilities** to address secure access of customer infor-

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mation, testing and monitoring, and scope of training to address fairness/equal service levels.

- **Implementation of needed change controls and mitigation steps** to address identified risks such as review/update of policies and procedures, tests to ensure changes do not trigger disparate treatment/impact, review of complaint reports and performing root cause analysis, documentation of responses to new regulations, maintenance of robust monitoring and testing, and leveraging fair lending expertise to understand your data.

FAIR LENDING ISSUES

The pandemic has disproportionately impacted certain protected classes[5] and civil unrest has heightened attention to disparities in certain geographic areas, prompting more lenders to evaluate where they are lending, and more importantly, where they *are not* lending, and to strategize on how they can better serve underserved communities. These goals are supported by industry associations' diversity and inclusion programs and awards and by committing resources to this focus. The Mortgage Bankers Association has a Diversity and Inclusion Resource Center on its website and presents annual awards for those companies that develop and increase diversity and inclusion within the leadership and employee base as well as initiatives specifically developed to increase outreach, marketing, and products to reach potential diverse homebuyers.[6]

In addition, lenders are increasingly utilizing artificial intelligence ("AI") to enhance their marketing, credit underwriting, and even servicing strategies. This use of big data and technology applications to mine the data to enhance efficiency and automate processes can also inadvertently result in disparate outcomes if not properly managed. The outputs that result from the use of these AI tools is where fair lending analysis needs to be implemented. Lenders must determine if a protected class is being inadvertently excluded.

TIPS FOR AVOIDING FAIR LENDING ISSUES

In addition to having a robust fair lending plan and performing an annual risk assessment, lenders can further mitigate their risk if they:

- Ensure the accuracy of their Home Mortgage Disclosure Act

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("HMDA") data with regular monitoring, analysis, and training.

- Analyze HMDA data to understand where applications are taken, loans are being made, and to whom they are made.
- Map applications and loans to facilitate analysis of where lending activity is taking place.
- Review and enhance reporting to the board of directors and management so they are aware of the company's current lending patterns, proposed strategies, and to document the requisite oversight.
- Employ the right resources and expertise to understand and analyze the institution's data and how it compares to peer data. If such fair lending expertise is not available in house, retain outside consultants and/or outside counsel and consider having such engagements performed under attorney-client privilege.

CALIFORNIA'S NEW DFPI

Pursuant to Assembly Bill 1864, as of January 1, 2021, the California Consumer Financial Protection Law ("CCFPL") goes into effect and expands the authority of the DBO. Generally, the focus of the new Department of Financial Protection and Innovation ("DFPI") will be on entities not previously regulated by the DBO, such as debt collectors, credit reporting agencies ("CRAs"), nonbank small business lenders and fintech companies. The DFPI will continue to have regulatory authority over entities the DBO currently has, but that authority is not expanded by the CCFPL. Specifically, residential mortgage lenders, mortgage servicers, or mortgage loan originators licensed under Division 20 of the Financial Code are exempted under the CCFPL. Those licensed by the Department of Real Estate ("DRE") will continue to be regulated by the DRE.

The legislation does give the DFPI broad regulatory and enforcement power, including the ability to conduct investigations, issue subpoenas, levy fines, bring civil and administrative actions. Additionally, the DFPI's authority to enforce the prohibition of Unfair, Deceptive or Abusive Acts or Practices ("UDAAP") was clarified to add the prohibition on "abusive" acts or practices to California law and authorized the newly formed agency to prescribe the rules that apply to those covered by this authority. The DFPI is specifically directed to interpret these terms consistent with existing California law and provisions of the Dodd-Frank Act, but to favor expansive coverage and greater protections for consumers.

With an assumed focus on fintech's, CRAs and other previously non-regulated entities, mortgage lenders and servicers do not know exactly what to expect from the DFPI. Some operational tips to avoid scrutiny from the DFPI include:

- Continue to monitor calculation of per diem interest calculations in loan origination, as it is a continuing focus of the agency.
- Conduct annual risk assessments, monitor and audit to identify UDAAP risks early as the business adapts to new rules and regulations.
- Stay abreast of DFPI activity and rulemaking.
- Participate in California Mortgage Banker Association committees, webinars, and conferences to understand the continuing changes impacting our industry.

As the financial services industry has adapted to changes during the COVID-19 pandemic, it will continue to do so following the elections. Lenders and servicers have historically proved themselves resilient and able to adapt to change. Now, more than ever, the industry must monitor regulatory activity and be strategic in how they steer their businesses through change in order to thrive.

1 Amendments and subsequent guidance to the 2013 Mortgage Rules issued by the CFPB Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z).

2 Fair Housing Act and Equal Credit Opportunity Act.

3 Interagency Guidance issued March 22, 2020, jointly by the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Consumer Financial Protection Bureau and the Conference on State Bank Supervisors.

4 15 United States Code § 1692k.

5 Centers for Disease Control and Prevention, Health Equity Considerations and Racial and Ethnic Minority Groups, July 24, 2020.

6 https://www.mba.org/2020-press-releases/october/mba-announces-2020-diversity-and-inclusion-residential-leadership-award-winners