THE NATIONAL LAW REVIEW

Settlement in Mortgage Discount Points Case Highlights Risk From Claimed Inconsistency Between Representations to Consumers and Actual Practices

FOLEY & LARDNER LLP
Article By
Jennifer M. Keas
Samantha A. Robbins
Foley & Lardner LLP

- Real Estate
- Financial Institutions & Banking
- Consumer Protection

- Kansas

Monday, December 18, 2017

A recent settlement of deceptive practice allegations against Peoples Bank of Lawrence, Kansas, (Peoples) by the Board of Governors of the Federal Reserve System (Board of Governors) serves as a reminder that unfair or deceptive acts or practices (UDAP) claims may be triggered based on perceived inconsistencies between representations a consumer financial services institution makes to consumers and its actual practices. In *Peoples*, while the Board of Governors found that Peoples' consumer disclosure accurately stated the costs that consumers would incur during the mortgage lending process, it alleged that Peoples was deceptive in charging discount points because consumers did not actually receive the corresponding benefit as represented to them.

Allegations in the *Peoples* Consent Order

The Board of Governors and the Federal Reserve Bank of Kansas City found that

Peoples' discount point practices were deceptive after examining its mortgage origination business.

Discount points are a means by which lenders offer consumers the option of paying a one-time upfront fee in exchange for a lower mortgage rate.[1] They are distinct from origination points, which a lender may charge for its services in making the loan. In general, one discount point will cost one percent of the total loan amount and lower the interest on the loan by approximately a quarter of a point (0.25 percent); however, mortgage pricing can be extremely variable and there is no single calculation that objectively explains how each discount point will correspondingly lower the interest rate from the par rate. After the Consumer Financial Protection Bureau (CFPB) finalized the "ability-to-repay" mortgage rule in 2013, lenders largely shifted to making loans meeting "qualified mortgage" (QM) standards,[2] which in turn implicate the concept of "bona fide discount points"—however, that concept is still quite general, providing only that the discount points paid by the consumer must reduce the interest rate based on a calculation that is "consistent with established industry practices."[3]

In the *Peoples* consent order, the Board of Governors alleged that for a period of more than four years (January 1, 2011 to March 5, 2015), Peoples had represented that discount points were being used to purchase a lower, discounted interest rate, but sometimes that was not accurate. The Board of Governors alleged that during the relevant period many borrowers did not actually receive a reduced interest rate or received a rate that was not reduced commensurate with the price paid for the discount points, which the Board of Governors asserted constituted a material misrepresentation. The Board of Governors claimed that Peoples had engaged in "deceptive acts or practices in or affecting commerce within the meaning of section 5(a)(1) of the [Federal Trade Commission] Act (15 U.S.C. § 45(a)(1)), and unsafe or unsound banking practices."[4] In settling the allegations, Peoples agreed to a restitution plan and paid $2.8 million into a qualified settlement fund.

The *Peoples* consent order did not include much in the way of underlying factual allegations (it also did not mention QM standards), but presumably the circumstances were sufficiently egregious that the Board of Governors felt that a consent order was warranted. The Board of Governors acknowledged that Peoples' disclosures had accurately depicted the amount borrowers would pay for their loans. Rather, the theory of alleged deception was based on an apparent disconnect between Peoples' representation that a specified portion of the fees paid at closing would be used to buy down the rate and what had actually occurred operationally.

Other Recent Claims Raise Similar Concerns

At the same time, banks have been receiving scrutiny related to rate-lock extension fees (*i.e.*, fees charged to a consumer to retain the initially quoted interest rate on the home loan if that rate otherwise would expire due to a delay in the mortgage application process caused by the borrower). Among other things, class action plaintiffs allege a systematic effort to charge unwarranted rate-lock extension fees under circumstances in which the delay was not caused by the consumer.[5]

Separately, the Consumer Financial Protection Bureau (Bureau) has been prosecuting a claim against a bank in Minnesota federal court under the Consumer Financial Protection Act of 2010, which prohibits "covered persons" from engaging in unfair, deceptive, or abusive acts or practices. In that case, the court issued a ruling in September allowing the Bureau to proceed with a deceptive practice claim because, while the bank indisputably provided a legally-mandated form relating to overdraft services for debit-card and ATM transactions, the bank's alleged conduct as part of the account opening process was likely to deceive or confuse customers about its overdraft services.[6]

What Can You Do To Minimize Risk?

The UDAP claims in the foregoing matters arise, at least in part, due to perceived gaps between what was represented to consumers and how the underlying program or fee allegedly worked in practice.

In the *Peoples* matter, the Board of Governors was concerned about whether Peoples' borrowers during the relevant period had received the full benefit of discount points as it had been represented to them. For many mortgage lenders, that risk may be minimized based on their existing QM compliance management system, although the Board of Governors noted that Peoples had lacked a specific written policy regarding discount points. To be on the safe side, lenders should ensure that their existing policies and procedures are aimed at ensuring that discount points are adequately disclosed to consumers and result in a proportional lowering of the interest rate as represented. Lenders should consider whether they are maintaining documentation sufficient to make that showing in response to a later challenge, such as documentation to demonstrate the starting rate to be adjusted for the particular consumer, the amount of discount points charged, and the reasoning for the resulting rate once discount points were applied. This could include, for example, retaining historic rate sheets or other pricing data to establish that the interest rate reduction given was consistent with the compensation that the lender reasonably expected to receive in the secondary market.

More generally, financial services providers should not necessarily assume that the mere provision of a legally required disclosure at the proper point in time will be sufficient to minimize legal risk. Rather, a good compliance management system also should focus on whether *the underlying practices* of the institution (and its service providers) correspond to representations made to consumers and whether anomalies or consumer complaints could indicate potential UDAP risk. In addition to developing policies and procedures appropriate for the size and scope of their operations, providers should provide periodic training and reminders to appropriate personnel. It is also wise to conduct periodic internal reviews of operations to ensure that they are functioning as intended. Lenders also should consider whether their existing policies and procedures regarding the Equal Credit Opportunity Act and the Fair Housing Act take into account any unintended disparate impact risk that could be presented by their fee or pricing practices.

---

[1] Discount points are common in the mortgage industry and can be beneficial to consumers and lenders alike. For borrowers, discount points potentially can decrease the monthly mortgage payment and lessen the total amount of interest that will be paid over the life of the loan. For lenders, discount points can

provide additional liquidity at origination.

[2] In 2013, the CFPB finalized a rule implementing an expanded ability-to-repay requirement under various Dodd-Frank Wall Street Reform and Consumer Protection Act amendments to the Truth in Lending Act/Regulation Z.

[3] *See* 12 C.F.R. § 1026.32(b)(3)("The term bona fide discount point means an amount equal to 1 percent of the loan amount paid by the consumer that reduces the interest rate or time-price differential applicable to the transaction based on a calculation that is consistent with established industry practices for determining the amount of reduction in the interest rate or time-price differential appropriate for the amount of discount points paid by the consumer.").

[4] Section 5 of the Federal Trade Commission Act (FTC Act) declares that unfair or deceptive acts or practices (so-called UDAP) affecting commerce are illegal. *See* 15 U.S.C. § 45(a). As was illustrated by the *Peoples* matter, the banking agencies (the Board of Governors, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision) have authority to enforce Section 5 of the FTC Act for the institutions they supervise. The Federal Trade Commission has authority to take action against nonbanks under Section 5 of the FTC Act.

[5] *See, e.g.,* https://www.washingtonpost.com/realestate/wells-fargo-accused-of-forcing-mortgage-applicants-to-pay-unwarranted-fees/2017/09/05/2ed18eaa-925a-11e7-8754-d478688d23b4_story.html; *see also Muniz v. Wells Fargo & Company*, No. 17-cv-04995 (N.D. Cal.).

[6] *Consumer Financial Protection Bureau v. TCF National Bank*, Case No. 17-cv-00166-RHK-DTS (D. Minn.).

Source URL: https://www.natlawreview.com/article/settlement-mortgage-discount-points-case-highlights-risk-claimed-inconsistency