THE IndependenceVoice

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The Consumer Financial Protection Bureau (CFPB) was created in 2010 in direct response to the financial crisis of 2008. As many remember, the crisis was set off by a number of problems in the subprime mortgage market, and the downstream selling of those mortgages in security markets. This reform process has been compared to the sweeping financial reforms of the 1930s that followed the Great Depression, which created the bulk of America's financial regulation as we know it today.

While the idea of a federal office specifically dedicated to consumer finance has been kicked around by policymakers for decades, experience with questionable subprime mortgage loans in the nineties and then through the housing bubble during the early years of the 21st century brought the idea back to the front of public debate.

The CFPB's objective is straightforward: To create access for all types of consumers to financial markets, products, and services that are fair, transparent, and competitive. The following are the stated goals of the CFPB, per their website:

1) Ensuring that consumers have timely and understandable information.
2) Prohibiting unfair, deceptive, abusive, or discriminatory business practices.
3) Identifying and addressing outdated or burdensome regulations.
4) Promoting transparent, efficient, and competitive markets for consumer financial products. That includes not only credit, mortgage and banking, but any predatory lending.

Background

Nationally, home prices nearly doubled between 2000 and 2006, vastly greater than the historical appreciation rate that roughly followed the rate of inflation. For residential properties (particularly in California, Nevada, Arizona, and Florida) annual appreciation was in excess of 35%, while the rest of the country had a much lower appreciation. Here in Texas we saw 2-3% annual appreciation as a state (50th in appreciation).

Residential homes had not traditionally been treated as investments subject to speculation, but this changed during the housing boom. Homes were being purchased while under construction, then being flipped for profit without the seller ever having lived in them. Some mortgage companies identified risks inherent in this activity as early as 2005, after identifying investors assuming highly leveraged positions in multiple properties.

Speculative borrowing in residential real estate has been cited as a contributing factor to the subprime mortgage crisis. During 2006, it is estimated 22% of all homes purchased (1.65 million units) were for investment purposes, with an additional 14% (1.07 million units) purchased as vacation homes. During 2005, these figures were 28% and 12%, respectively. In other words, a record level of nearly 40% of

homes purchased was not intended as primary residences. David Lereah, National Association of Realtors chief economist at the time, stated that the 2006 decline in investment buying was expected: “Speculators left the market in 2006, which caused investment sales to fall much faster than the primary market.”

Many loans were made to consumers who did not understand the consequences of borrowing 120% of their equity in their properties on a frequent basis, in some cases as often as every 90 days. The belief was that real estate would continue to appreciate dramatically in value, therefore covering the basis of making the loan. Other offerings were stated income loans with little to no verification of the stated income. In later years these would be referred to as ‘liar loans’. Additionally, zero-down and loans became common, allowing buyers to purchase a home with no down payment or equity in play.

Looking back, risky loans were based on a faith that home prices would increase to infinity. Other investments do not allow the leverage that real estate allowed at the time. Many companies did not change the underwriting treatment of a home (which was traditionally a conservative inflation hedge) to a full scale speculative investment. American Nobel Laureate, economist, academic, and best-selling author Robert Shiller argued that speculative bubbles are fueled by “contagious optimism, seemingly impervious to facts, that often takes hold when prices are rising. Bubbles are primarily social phenomena; until we understand and address the psychology that fuels them, they’re going to keep forming.” Another noted wise investor, Warren Buffett, testified to the Financial Crisis Inquiry Commission: “There was the greatest bubble I’ve ever seen in my life...The entire American public eventually was caught up in a belief that housing prices could not fall dramatically.”

Why the history lesson? Looking back, there were a small percentage of predatory lenders that took advantage of prospective home buyers by writing loans that were destined to fail when the home bubble burst and the market inevitably corrected itself. Ultimately, many of these predatory loans failed when the market crashed and many borrowers found themselves underwater.

Sure enough, after several years of these aggressive – and in some cases, fraudulent – lending practices, homeowners began to default on their loans at an alarming pace. To make matters worse, many longstanding corporate entities (like the insurance giant AIG) had made aggressive positions on these mortgages.

As the subprime market crashed, many companies like AIG and Lehman Brothers that were on the wrong side of the speculation got in deeper and deeper trouble and eventually many failed or had to be bailed out by the federal government. The stock market crash (in which the Dow Jones Industrial Average lost almost half its value) also decimated many Americans retirement accounts. It is estimated over $7.5 trillion in equity was lost nationally. The country and most of the world has still not recovered. Nationally only 65 counties out of nearly 3,100 have fully recovered in home values and employment.

Implications

With the fallout from the financial crisis fresh in the minds of lawmakers and newly elected administration, the CFPB was created in 2008 to be a "watchdog" for consumers against the potential predatory actions of financial companies. Following is a list of some of the reforms instituted by the CFPB:

Ability-to-Repay/Qualified Mortgage

Until recently, lenders were allowed to direct borrowers toward high-interest loans, which are more profitable for lenders, even if they qualified for a lower-cost mortgage—a practice that helped lead to the financial crisis. In early 2013, the CFPB issued a rule that effectively ends this conflict of interest.

Integrated Disclosures

Integrated disclosures should make the lending process easier for consumers to understand. The CFPB has set August 1, 2015 as the effective date for the new Loan Estimate and Closing Disclosure forms that will (almost) replace the Good Faith Estimate, Truth-in-Lending, and HUD-1 disclosures used today. Reverse mortgages and certain home equity transactions will continue to use the current disclosure, which could create some confusion on those rare 80/10/10 transactions.

Perhaps the biggest change is the new "three day rule," which requires that the borrower receive the Closing Disclosure form three full business days prior to consummation. Lenders and settlement agents are already beginning to work out the details about how this new form will be produced and delivered. All real estate professionals will require training on the new forms in order to help guide their buyers and sellers. In addition, the consumer gets a low-cost home loan counselor. In January 2013, the CFPB required the vast majority of mortgage lenders to provide applicants with a list of free or low-cost housing counselors who can assist buyers in making smart lending choices.

Quality Service Providers (such as Independence title and others)

While Realtors and the industry are dealing with new borrower qualifying requirements, and will be dealing with new disclosures next year, CFPB and other regulators have been putting increasing pressure on all lenders and parties involved to ensure that their third-party service providers meet very high standards. This, in turn, has caused lenders to put title and settlement providers under a microscope as they routinely handle vast sums of lender funds and considerable amounts of consumers' personal information. Expect lenders to be spending more time on their approved settlement provider lists as the "flight to quality" continues to accelerate.

Affiliated Business Arrangements

Most of us go to a real estate professional and take direction on where we should get our financing, title work, etc from. This is what many in the industry call 'captured business'. The CFPB is taking a hard look at the operational and financial aspects of these arrangements. Is it a 'kickback' or financial gain for the referred business? CFPB has taken over enforcement of RESPA from HUD and they are serious about making sure ABA's are operating under both the spirit and letter of the law. Recent enforcement actions demonstrate the Bureau's intention to ensure that consumers are aware of these arrangements and understand their options for mortgage and title and settlement services. Brokers with mortgage and or title ABA's should pay special attention to compliance in the new era.

There is much more than anyone can cover in one blog posting. But suffice to say, you as a consumer or real estate professional need to understand the implications of the new agency. If you have a question, ask. If your realtor, lender, title company, etc. cannot answer you probably need to continue to look and find an appropriate representative that can.

I would suggest that you look at lenders, builders, and title companies that are equipped to comply with the parameters put in place by the CFPB. Should you have further questions, Independence Title has a wealth of resources. Contact our Education Team and study the resources posted on our blog:

New standards for mortgage lending
New Consumer Finance Protection Bureau Regulations
Video | CFPB- What It Is and Why We Care
CFPB Chat

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