

To the Point!

legal, operations, and strategy briefs for financial institutions

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Unearned Discount Points

When the Consumer Financial Protection Bureau (the “CFPB”) recently issued guidance on mortgage servicing transfers it also reminded the mortgage industry that the agency will continue to examine it for compliance with existing laws, pending the new mortgage rules becoming effective in January 2014. As we previously reported, the new rules on qualified mortgage standards under Regulation Z will exclude bona fide discount points from the calculation of points and fees to determine whether a loan is a qualified mortgage, subject to certain limits based on the

difference between the pre-discount rate and the average prime offer rate. Lenders will be required to establish policies related to discount points that will comply with the new rules; however, it is important to note that charging discount points in loan transactions has additional compliance implications that apply today and will continue to apply after the effective date of the new rules.

Charging unearned discount points is a practice where the borrower pays discount points but does not receive a proportionate discount in the loan’s par interest rate. Discount points charged by a lender must be earned. Charging unearned discount points may be viewed as an unfair and deceptive trade practice that violates Section 5 of the Federal Trade Commission Act because the lender would charge for a service (to receive lower rates) without providing the service. Similarly, the CFPB may also consider such practices unfair, deceptive or abusive and take enforcement action. Such practices could also have fair lending implications under the Equal Credit Opportunity Act and the Fair Housing Act if charging unearned discount points is found to have a disparate impact on customers in a protected class.

As lenders develop new policies to satisfy the requirements of the new rules on qualified mortgage standards, lenders must also ensure that loan officers are trained and understand the risks associated with unearned discount points. The lender’s pricing guidelines should state that loan officers are prohibited from charging discount points that do not result in a proportionate lowering of the interest rate. Procedures and controls should be adopted related to mortgage loan pricing to prevent loan officers from representing to borrowers that the rate will be lowered if discount points are paid, without actually lowering the rate. Finally, when discount points are charged the loan file should have sufficient records to indicate the par rate, discount points charged and the lowered loan rate.



New Mortgage Foreclosure Rules in Illinois

On February 22, 2013, the Illinois Supreme Court adopted new rules that impact mortgage foreclosures in Illinois. The new rules contain:

- Requirements for mortgage foreclosure-specific mediation programs within Illinois’ judicial circuits;
- Required practice, procedure and notice obligations; and

- Requirements with respect to loss mitigation programs.

For example, the new rules contain requirements with respect to what must be: attached to the foreclosing plaintiff's complaint, set forth in prove-up affidavits, and contained in loss mitigation affidavits.

Lenders and their counsel should review the new rules before filing new foreclosure actions or proceeding with pending cases in order to ensure that their foreclosure practices and procedures are in compliance with the new rules.

The judicial circuit mortgage foreclosure-specific mediation program rules are effective on March 1, 2013. The other new rules are effective on May 1, 2013.



Cybersecurity and Reputational Risk

The risks and issues related to cyberattacks and cybersecurity affect enterprises in all industries, both private and public, including financial institutions. In remarks at the 2013 Banking Outlook Conference in Atlanta, Georgia, Sarah Bloom Raskin, a member of the Board of Governors of the Federal Reserve System, discussed the increasing cybersecurity threats that banks are facing, which include distributed denial-of-service attacks, hacking and the possible theft of proprietary data and personal information of customers. Raskin explained that threat of cyberattacks and adequate cybersecurity protections are increasingly important because customers depend more and more on Internet-based tools such as mobile banking, which are additional entry points to the bank's systems and infrastructure that must be protected.

To address these risks, Raskin identified ways these risks are being mitigated through cooperative efforts between the government and industry and technological innovations in protective solutions. Raskin also mentioned Executive Order 13636 (the "Executive Order") recently issued by the President as another indicator of the importance of the issue of cybersecurity and the continued commitment by the government in partnering directly with the industry to address these risks. The Executive Order is focused on improving the cybersecurity of the nation's "critical infrastructure," broadly defined as "systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters." The term presumably includes communications, defense, healthcare, information technology and financial services. Notably, the Executive Order requires federal agencies to produce unclassified reports of threats relevant to U.S. companies and share them in a timely manner to address and prevent attacks. More significantly, the Executive Order requires the development of an overall framework that includes standards, methodologies, procedures and policies that are applicable to all enterprises to identify, assess, manage and reduce cyber risk.

The relationship between cybersecurity and its impact on reputation and the trust of the public in our financial systems, and the issuance of the President's Executive Order, highlight the importance of cybersecurity for all financial institutions. Financial institutions should be proactive in continuously monitoring cyberattacks and issues in cybersecurity and update internal policies and procedures as necessary. In addition, financial institutions should make themselves aware of and utilize the governmental resources available currently and in the future to develop or supplement their own policies and procedures over cybersecurity.

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