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TRID Liability Will Be A Dominant Issue In 2016

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Oct. 3, 2015, was a watershed moment for the mortgage origination industry and the Consumer Financial Protection Bureau. On that date, the CFPB's long-awaited Know Before You Owe: TILA-RESPA Integrated Disclosure (TRID) rule finally became effective, marking the end — for most mortgages — of 30 years of separate, overlapping disclosures under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA), and the beginning of TRID's loan estimate and closing disclosure.

Measured against their predecessors, the new TRID forms are a marked improvement in terms of prioritizing and explaining the cost information that consumers care most about when selecting a mortgage.[1] But the first round of loans closed under TRID is troubled. The quality control vendors that assess compliance are reporting extraordinary levels of errors, and private investors are rejecting loans at seemingly unprecedented rates, citing violations of the rule's requirements.

Some of these errors are technical, some are not. These findings may suggest problems with the rule itself or with its implementation by the myriad lenders, vendors, mortgage brokers, appraisers, settlement agents and other players that must coordinate to produce a mortgage loan. Or the findings may suggest that the rule is being interpreted inconsistently or that the private investors who purchase loans are adopting a particularly conservative standard.

In our work advising lenders, investors and other market participants, we have seen evidence to support all of these theories. The root of the problem, however, is that it may not be possible to get TRID "right" at the level that many came to expect under the old TILA disclosures.

The TRID disclosures attempt to explain the inexplicable: a complex and highly localized process for lending money secured by real estate that grows even more complicated when combined with a transfer of ownership (in other words, borrowing money to buy a house). TRID attempts to account for that complexity, but it is an impossible task. As a result, the rule can be simultaneously overbearing and incomplete; byzantine at times and overly simplistic at others. Under these circumstances, some level of violations is inevitable, and the question should not be whether such errors are acceptable, but how to fix them so that consumers are not harmed and loans continue to be made, sold and securitized.

The CFPB has repeatedly stated that concerns regarding TRID are overblown. However, it has also acknowledged that, "[a]s with any change of this scale, despite the best efforts, there inevitably will be inadvertent errors in the early days."[2] Worries persist that the feedback from the first round of TRID loans is only the beginning and that TRID violations will expose lenders to lawsuits and prevent them from selling their loans, cutting off a process that is essential to a recovering housing market. As discussed below, these risks can be managed — but not eliminated — through a careful analysis of TILA's liability scheme, strong quality control reviews and prompt corrective action.

Initial Responses to TRID Concerns

Acknowledging that errors are inevitable during the early days of TRID implementation, the CFPB, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corp. have issued statements that, while not identical, establish their expectation that lenders will "make good faith efforts to comply with the TRID Rule's requirements in a timely manner." These agencies stated that, in early TRID examinations, their examiners will consider the lender's "implementation plan, including actions taken to update policies, procedures, and processes, its training of appropriate staff, and its handling of early technical problems or other implementation challenges." [3]

Fannie Mae and Freddie Mac have issued similar notices, stating that, "until further notice, [they] will not conduct routine post-purchase loan file reviews for technical compliance with TRID" and that they do "not intend to exercise contractual remedies, including repurchase, for noncompliance with the newly applicable provisions of TRID except in two limited circumstances: [1] if the required form is not used; or [2] if a particular practice would impair enforcement of the note or mortgage or would result in assignee liability, and a court of law, regulator or other authoritative body has determined that such practice violates TRID."[4]

Finally, HUD also issued a letter stating that "it will not include technical TRID compliance as an element of its routine quality control reviews" but that it "does expect mortgagees to make good faith efforts to comply with TRID, which, at a minimum requires the use of the TRID required forms." Importantly, however, HUD did not state that it would forgo False Claims Act or other penalties for noncompliance with TRID; instead, it "remind[ed] mortgagees of the requirement to comply with all federal, state, and local laws, rules, and requirements applicable to the mortgage transaction."[5]

Remaining Uncertainty

Although these assurances are helpful to lenders planning for examinations, selling loans to Fannie and Freddie, and making FHA loans, they do not address concerns about liability for TRID violations in a private suit brought by a borrower against a lender or investor under TILA. Nor do they address what may be the primary deterrent for secondary market purchasers and securitizers of mortgage loans: the risk that any TRID violation will violate a contractual representation that the loan was originated "in compliance with law."

Borrowers should be made whole for any harm caused by TRID errors, but such harm is likely to be rare for violations of the rule's more technical requirements. Therefore, the question is whether TRID liability is properly calibrated to the type of violation.

Congress mandated that the bureau combine the TILA and RESPA disclosures, but it did not amend TILA or RESPA to clarify the liability for violations of the new disclosures.[6] Because TILA generally permits private suits for violations of its mortgage disclosure requirements but RESPA does not, this silence raised concerns that borrowers would be permitted to sue lenders and potentially investors for any violation of TRID, no matter how minute.[7]

Rather than creating a bright-line rule to address this issue, the CFPB explained that the "detailed discussions of the statutory authority for each of the integrated disclosure provisions [in the CFPB's preamble to the final rule] provide sufficient guidance for industry, consumers, and the courts regarding the liability issues raised by the commenters."[8]

This means that not all TRID violations are created equal. When faced with a violation of the TRID rule, a lender or investor must carefully review the TRID rule's lengthy preamble to determine whether the CFPB used TILA authority that carries a private right of action when adopting the TRID provision at issue. In the TRID preamble, the CFPB relied on Parts A and B of TILA as authority for various provisions of the rule. However, TILA allows a borrower to sue only for violations of requirements imposed under Part B.[9] Therefore, it appears that a private suit may be brought for violations of TRID requirements imposed under Part B but not for violations of requirements imposed under Part A. Of course, it remains to be seen how courts will apply TILA liability in the context of TRID. Furthermore, state law may provide private rights of actions for violations of federal law even when federal law does not.

For an investor considering whether to purchase a loan with the TRID error, there are two additional layers: assignee liability and contractual representations. Even if TILA permits the borrower to sue the lender, the investor (assignee) can only be held liable if the violation is apparent on the face of the disclosures. Specifically, an assignee is liable for violations of TILA in connection with transactions secured by real property when (1) the violation "is apparent on the face of the disclosure statement provided in connection with [the] transaction," and (2) the assignment to the assignee was voluntary. A violation is "apparent on the face of the disclosure" if (1) "the disclosure can be determined to be incomplete or inaccurate by a comparison among [a] the disclosure statement, [b] any itemization of the amount financed, [c] the note, or [d] any other disclosure of disbursement;" or (2) "the disclosure statement does not use the terms or format required to be used by [TILA]."[10]

Accordingly, issues related to the sale of loans may lessen only if secondary market participants begin to focus on the subset of TRID violations that carry the potential for a private right of action against the investor (as opposed to the lender), which will reduce the number of negative findings and increase the acceptance of loans with TRID errors.

However, after nearly a decade of litigation among market participants (and governmental entities) related to alleged loan defects, investors are wary that any TRID violation — no matter how minor or technical and regardless of whether it carries a private right of action or assignee liability — could give rise to an indemnification or repurchase demand based on an unqualified contractual representation that the loan was originated "in compliance with law." It appears that these concerns will wane only if the contractual agreements themselves are modified to exclude specified technical violations from the representations and warranties or to otherwise limit indemnification and repurchase demands based on such violations.

CFPB Letter on TRID Liability

In an effort to calm concerns regarding investors' reaction to TRID violations, CFPB Director Richard Cordray recently responded to a letter from Mortgage Bankers Association President David Stevens. In his response, Cordray suggested that investor rejection of TRID loans based on "formatting and other minor errors" is "an overreaction to the initial implementation of the new rule" and expressed hope that this issue "will dissipate as the industry gains experience with closings, loan purchases, and examinations."[11]

The letter states that, while the TRID rule incorporates RESPA requirements into TILA's implementing regulation (Regulation Z), "it did not change the prior, fundamental principles of liability under either TILA or RESPA." The letter reiterates TILA's standard for assignee liability, as discussed above, and emphasizes the ability of lenders and investors to "cure" TRID violations, as discussed below.

Cordray's letter also makes several statements about the availability of "statutory and class action damages" in a private suit based on TRID violations, which are up to $4,000 in an individual suit and up to the lesser of $1 million or 1 percent of the creditor's net worth in a class action.[12] Statutory damages are distinct from both actual damages, which are available in all private suits under TILA if the violation caused actual harm to the borrower, and attorneys' fees, which are available in any successful action for liability under TILA.[13]

First, the letter states that statutory damages are limited to the "failure to provide a closed-set of disclosures." A "closed-set of disclosures" appears to refer to the unnumbered paragraph following 15 U.S.C. § 1640(a)(4), in which Congress limited statutory damages for violations of 15 U.S.C. § 1638 to a specific list of disclosure requirements, including the annual percentage rate (APR) and finance charge (the "listed § 1638 disclosures").

Second, the letter states that the listed § 1638 disclosures "that give rise to statutory and class action damages do not include either the RESPA disclosures [incorporated into TRID] or the new Dodd-Frank Act disclosures [added to § 1638], including the Total Cash to Close and Total Interest Percentage." It further states that "[f]ormatting errors and the like are unlikely to give rise to private liability unless the formatting interferes with the clear and conspicuous disclosure of one of the disclosures listed as giving rise to statutory and class action damages in 15 U.S.C. § 1640(a) [i.e., the listed § 1638 disclosures]."

The letter concludes that the risk to private investors from "good-faith formatting errors and the like" is "negligible" and that investors rejecting loans on that basis "would be rejecting loans for reasons unrelated to potential liability associated with the Know Before You Owe [i.e., TRID] mortgage disclosures."

However, the letter appears to address only the liability associated with violations of TRID requirements adopted under the listed § 1638 disclosures, whereas TILA liability extends to all of Part B of the act.[14] Furthermore, liability under § 1638 is not limited to statutory damages because borrowers may recover actual damages and attorneys' fees.[15]

In addition, there is no indication that the letter was issued as an official interpretation under either Section 130(f) of TILA or Section 19 of RESPA. Accordingly, it does not appear that Cordray's statements are binding on the CFPB, other regulators or courts.[16] The CFPB could, however, issue an official interpretation specifying the liability (or lack thereof) associated with violations of individual TRID provisions. Furthermore, because that liability depends on the TILA or RESPA authority used by the CFPB to adopt the TRID provision, the CFPB could also adjust the underlying authority to ensure that the CFPB, not the courts, is responsible for assessing compliance with formatting and other technical issues.

Finally, even though Cordray's letter addresses a lender's or assignee's direct liability under TILA for TRID violations, it does not — and cannot — address how loan purchasers, securitization trustees and federal agencies enforcing the False Claims Act or the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) will react to the discovery of technical violations. To address that risk, the CFPB would need to formally declare that, for some period of time, "formatting and other minor errors" are not, in fact, violations.

Curing TRID Violations

Even when a TRID violation carries a private right of action, it is possible to "cure" that violation through prompt corrective action in many cases. The TRID rule allows lenders — and by extension investors — to avoid liability in the following circumstances:

- The creditor discovers a non-numeric clerical error on the closing disclosure and provides a corrected closing disclosure within 60 days after consummation.[17]

- The consumer pays amounts in excess of the tolerances (limitations) on closing costs, but the creditor refunds the excess amounts and provides a corrected closing disclosure to the consumer no later than 60 days after consummation.[18]

As the CFPB noted in the TRID rule, TILA provides additional mechanisms for lenders and investors to limit their liability for certain errors.[19] Specifically, TILA states that a creditor or assignee can:

- Avoid civil, administrative, and criminal liability under TILA for "any failure to comply with any requirement imposed under [Part B]" if the creditor or assignee: (a) notifies the consumer of the error within 60 days of discovery (but before an action has been instituted or the borrower notifies the creditor of the error in writing); and (b) "makes whatever adjustments in the appropriate account are necessary to assure that the person will not be required to pay an amount in excess of the charge actually disclosed, or the dollar equivalent of the annual percentage rate actually disclosed, whichever is lower."[20]

- Avoid civil liability or an extended right to rescind under TILA "if the creditor or assignee shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programing, and printing errors, except that an error of legal judgment with respect to a person's obligations under this subchapter is not a bona fide error."[21]

These provisions of TILA predate TRID so lenders and investors should perform a careful examination of their application by courts when developing their TRID correction policies.

Notably, in his letter on TRID liability, Cordray stated that, "consistent with existing [TILA] principles, liability for statutory and class action damages would be assessed with reference to the final closing disclosure issued, not to the loan estimate, meaning that a corrected closing disclosure could, in many cases, forestall any such private liability." This statement could be read to suggest that, in the CFPB's view, many TILA violations on the loan estimate or closing disclosure — which are significant issues for early TRID loans — may be "cured" with a corrected closing disclosure. While potentially very helpful to resolving concerns about TRID liability, it remains to be seen if courts or regulators will interpret TILA and TRID in the same fashion.

Because the TILA and TRID "cure" provisions are generally conditioned on prompt corrective action, lenders and investors should continue to perform targeted quality control reviews on closed loans to identify and, to the extent possible, address errors. Unfortunately, however, it is unclear at this time whether these cure provisions will be viewed as "cure-alls" by courts and regulators or whether some types of TRID violations cannot be corrected.

Conclusion

Lenders and secondary market participants are nervous about TRID, with good reason. Initial reports of high defect rates have many on edge, and uncertainty regarding the ability of lenders to remedy those defects exacerbates the situation. However, mortgage lending will continue so we are hopeful that — with or without additional action by the CFPB — this uncertainty will lessen over time as lenders and investors develop a common understanding of TRID.

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[1] Disclaimer: Benjamin Olson led the development of the proposed TRID disclosures and regulations during his time at the CFPB.

[2] Letter from Richard Cordray, Director, CFPB to David Stevens, President and CEO, Mortgage Bankers Assoc. (dated Dec. 29, 2015), http://static.ow.ly/docs/Director%20Cordray%20to%20David%20Stevens%20MBA%202015.12.29%20copy_49CV.pdf

[3] See CFPB Blogpost: "CFPB Sends Industry Letter on Know Before You Owe Mortgage Disclosure Rule Compliance," http://www.consumerfinance.gov/newsroom/cfpb-sends-industry-letter-on-know-before-you-owe-mortgage-disclosure-rule-compliance/; Letter from Thomas J. Curry, Comptroller of the Currency, to Frank Keating, Am. Bankers Assoc. (Oct. 1, 2015), https://www.aba.com/Tools/Function/Mortgage/Documents/OCC-Response-TRID-Guidance.pdf; FDIC Financial Institution Letter FIL-43-2015 (Oct. 2, 2015), https://www.fdic.gov/news/news/financial/2015/fil15043.pdf.

[4] Fannie Mae Lender Letter LL-2015-06 (Oct. 6, 2015),

https://www.fanniemae.com/content/announcement/ll1506.pdf; Freddie Mac Letter, “Information Related to the Know Before You Owe TILA-RESPA Integrated Mortgage Disclosure Rule” (Oct. 6, 2015), http://www.freddiemac.com/singlefamily/guide/bulletins/pdf/iltr100615.pdf.

[5] “Information to Mortgagees on FHA’s position on the implementation of the Consumer Financial Protection Bureau’s Know Before You Owe TILA-RESPA Integrated Disclosure (TRID) rule” (exp. Apr. 16, 2016), http://www.buckleysandler.com/uploads/1082/doc/FHA_Position_On_CFPB_TRID_Rule.pdf.

[6] Dodd-Frank Wall Street Reform and Consumer Protection Act § 1032(f).

[7] 15 U.S.C. § 1640; 12 U.S.C. §§ 2601 et seq.

[8] 78 Fed. Reg. 79730, 79757 (Dec. 31, 2013).

[9] 15 U.S.C. § 1640(a). TILA also provides a private right of action for violations of Parts D and E, which are not relevant to TRID.

[10] 15 U.S.C. § 1641(e). TILA permits the CFPB and other regulators to assert assignee liability, but such actions are rare with respect to mortgages.

[11] Letter from Richard Cordray, Director, CFPB to David Stevens, President and CEO, Mortgage Bankers Assoc. (dated Dec. 29, 2015), http://static.ow.ly/docs/Director%20Cordray%20to%20David%20Stevens%20MBA%202015.12.29%20copy_49CV.pdf.

[12] 15 U.S.C. § 1640(a)(2).

[13] 15 U.S.C. § 1640(a)(1) and (3).

[14] 15 U.S.C. § 1640a).

[15] 15 U.S.C. § 1640(a)(1)-(3).

[16] See, e.g., Decision of the Director (Public Version), In the Matter of PHH, et al., File No. 2014-CFPB-0002, at 17-19 (concluding that HUD letter responding to industry concerns regarding RESPA compliance was “not in such a form as to be binding on any adjudicator” and provided “no protection to PHH in this proceeding” because it was not an official interpretation published in the Federal Register).

[17] 12 C.F.R. § 1026.19(f)(2)(iv).

[18] 12 C.F.R. § 1026.19(f)(2)(v).

[19] The bureau stated in the preamble to the TRID rule that it did “not intend to modify the scope or applicability of TILA Section 130(b) or (c), which sets forth treatment for errors related to certain disclosures.” 78 Fed. Reg. at 79882.

[20] 15 U.S.C. § 1640(b).

[21] 15 U.S.C. § 1640(c).