Impact of Dodd-Frank Act on Community Banks in Michigan

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The Dodd-Frank Act Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") includes major new consumer protection provisions. Title X of the Act, known as the "Consumer Financial Protection Act," creates a Consumer Financial Protection Bureau with wide ranging powers to regulate, supervise and enforce federal consumer financial protection statutes. Title XIV, known as the Mortgage Reform and Anti-Predatory Lending Act ("Mortgage Reform Act") of the imposes significant new requirements and limitations on the terms of residential mortgage loans and on mortgage loan originators, including brokers and lenders.

The provisions of the Dodd-Frank Act will usher in a new era of heightened consumer regulation and protection. The Act signals a shift in scope for consumer financial regulation. The Federal Truth in Lending Act was premised on the belief that by assuring accurate and uniform disclosures of the terms of credit, the Act could enable a consumer to compare loan offers and choose the loan that was in the consumer's best interest. The provisions of the Consumer Financial Protection Act and the Mortgage Reform and Anti-Predatory Lending Act involve the government more directly in regulating the terms of credit and other products, such as interchange fees. With the creation of the Bureau of Consumer Financial Protection, the Act establishes an independent federal agency devoted exclusively to protecting consumers in financial transactions.

Much of the Dodd-Frank Act focuses on large financial institutions that contributed to the recent financial collapse. The consumer protection provisions, while they distinguish between larger banks and community banks (bank's with assets of $10 billion or less), will have a enormous impact on all banks, large and small alike. The table below summarizes the most significant consumer protection provisions and discusses their impact on community banks. The table is just a summary. The details of the changes will be revealed over the next couple of years as new regulations are drafted and take effect.

The Financial Services Group at Warner Norross & Judd will be tracking those regulations and other developments as the Dodd-Frank Act takes effect. If you have questions about the Act, please contact a member of our Group.

Provision	What This Means to Community Banks	Effective Date
Creation of the Bureau of Consumer Financial Protection		
Title X of the Dodd-Frank Act establishes the Bureau of Consumer	The creation of the CFPB, which, though housed in the Federal	Supervisory authority over Federal Consumer Financial

Financial Protection ("CFPB"), which has as its mission "ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive." The CFPB has exclusive authority to issue regulations, orders and guidance implementing "Federal Consumer Financial Law." Federal Consumer Financial Law includes the Consumer Financial Protection Act of 2010 (Title X of the Dodd-Frank Act), plus the Truth in Lending Act, the Truth in Savings Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, and numerous other consumer statutes.	Reserve will be an independent agency, focuses the attention of one federal agency on consumer financial issues and regulation. The CFPB is established immediately, but several months will pass before a director is appointed and the CFPB's staffing and funding are in place. Then the agency will need to begin the process of drafting regulations and organizing its supervisory functions.	Law will not pass to the CFPB until the "Designated Transfer Date," which will be a date designated by the Secretary of the Treasury that is at least 180 days and not more than 12 months after the date the President signed the bill into law. The Secretary can extend the deadline by making a submission to Congress, but the Designated Transfer Date must occur within 18 months after enactment.
Who the CFPB Regulates		
The CFPB will have primary responsibility for examining, supervising, and enforcing compliance with Federal Consumer Financial Law by depository financial institutions with assets exceeding $10 billion. Community Banks with assets of $10 million or less will still be subject to regulations issued by the CFPB and can be required to provide reports to the CFPB. The CFPB may also participate "on a sampling basis" in an examination by a bank's prudential regulator to assess	While the CFPB does not directly supervise community banks with assets of $10 million or less, the actions it takes in regulation larger financial institutions is likely to have a significant impact on how the Federal Reserve, FDIC and Comptroller of the Currency go about assuring compliance by community banks with Consumer Financial Law. The CFPB will refer potential violations of Federal Consumer Financial Law to a bank's federal bank regulator with a	

compliance with Federal Consumer Financial Law. The Act, however, gives exclusive authority to enforce Federal Consumer Financial Law with respect to banks with assets of $10 billion or less to the bank's federal bank regulator.	recommended action. The act requires the bank's regulator to provide a written response to the CFPB within 60 days.	
The CFPB will supervise compliance with Federal Consumer Financial Law by all nondepository covered persons, including, for example, mortgage brokers and nondepository mortgage lenders, as well as larger participants in the market for consumer financial products or services (as determined by the CFPB and the Federal Trade Commission). CFPB will subject many nonbank competitors, such as mortgage companies, to examination and enforcement. Most notably, however, automobile dealers who sell their paper will be exempt from supervision and examination by the CFPB.	In theory, this will help level the playing field for community banks by reigning in previously unregulated players in the market, such as mortgage brokers.	
Authority to Prohibit Unfair, Deceptive and Abusive Practices		
In addition to its rulemaking authority under Federal Consumer Financial Law, the CFPB is authorized to issue rules and take enforcement actions to prohibit unfair, deceptive or abusive acts or practices in connection with a consumer of a consumer financial product. The CFPB may only issue such rules if it has a reasonable basis to conclude that (a) the act or practice causes, or is likely to cause,	The Dodd-Frank Bill specifically requires the CFPB to engage in cost-benefit analysis, weighing the injury to consumers who the regulation is aimed at protecting against the benefit of the practice to consumers or competition. It will be interesting to see how that balance is struck.	The Designated Transfer Date

substantial injury to consumers that cannot reasonably be avoided, and (b) the substantial injury to consumers is not outweighed by countervailing benefits to consumers or to competition.		
The CFPB may not declare a practice abusive unless the practice (a) "materially interferes with the ability of the consumer to understand a term or condition of a consumer financial product or service," or (b) takes unreasonable advantage of a consumer's lack understanding of the material risks, costs, or conditions of a product or service, the consumer's inability to protect his or her interests in selecting or using a consumer financial product or service, or the consumer's reasonable reliance upon the provider of the consumer financial product or service to act in the interests of the consumer.	State and federal law, such as the Michigan Consumer Protection Act and the Federal Trade Commission Act, already prohibit unfair and deceptive acts or practices. The prohibition of "abusive" practices is new. "Abusive" is defined to include, among other things, taking unreasonable advantage of "the reasonable reliance by the consumer" that the bank will "act in the interests of the consumer." Here, and elsewhere in the Act, the Act appears to imply a duty of a financial institution to act in the best interests of the consumer rather than placing responsibility on the consumer.	
Authority to Prohibit Predispute Arbitration Clauses		
The CFPB is given the authority to prohibit or impose conditions and limitations on predispute arbitration clauses. The Mortgage Reform Act also prohibits mandatory arbitration clauses in mortgage or home equity loans.	Predispute arbitration clauses are not widely used by community banks in Michigan, so this provision may have a limited impact.	180 days after the effective date of the regulation
Power to Enforce Fair Lending Laws		
The Consumer Financial Protection Act creates the Office of Fair Lending and Equal Credit	While the CFPB does not directly regulate Community Banks with assets of $10 million or less, the	One year after the Designated Transfer Date

Opportunity within the CFPB, with oversight and power to enforce the Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act.	CFPB's focus on fair lending will likely force the banking regulators to increase their focus as well.	
The Mortgage Reform Act requires the Federal Reserve Board to prescribe regulations that prohibit a mortgage originator from engaging in any abusive or unfair lending practice that promotes disparities based on race, ethnicity, gender or age among consumers of equal creditworthiness.	The Act appears to create a new basis, in addition to the Equal Credit Opportunity Act and the Fair Housing Act, for a claim of discrimination. It is not clear whether, by referring to promoting "disparities" Congress meant the current theories of disparate treatment and disparate impact that serve as the basis for discrimination claims, or whether Congress created a new theory of liability.	
The Consumer Financial Protection Act significantly expands the information that must be included in a mortgage lender's Home Mortgage Disclosure Act submission. Lenders will be required to collect and report detailed information about each loan, including among other things, total points and fees at origination, the value of real property pledged as collateral, the channel through which the loan was originated, the applicant's age and credit score, the term of the loan and any provisions that provide for a prepayment penalty or allow for payments that are not fully amortizing. The Act allows the CFPB to require additional disclosures as it deems appropriate.	These requirements significantly increase the amount of information that a lender must disclose in preparing its HMDA submission. This information will give the federal government significantly more information that it can use to build a case that a discrimination case that a lender discriminates against borrowers in a protected class. In the past, lenders have been able to argue that HMDA data lacked sufficient information about the applicant's creditworthiness and the terms of the loan to draw conclusions about discrimination. The new data required by the Act will allow the government and private litigants to overcome the current weakness in HMDA data and target lenders more aggressively.	
The Act will require lenders to collect information regarding small	Over the past decade, the federal government has shown a greater	

business loans, including whether the business is women-owned or minority-owned. Information required to be collected and reported includes, among other information, the race, sex, and ethnicity of the principal owners of the small business, the gross annual revenue of the small business applicant, the census tract in which the business is located, and the type of action taken on the application. The CFPB may require additional information as it deems appropriate.	interest in pursuing discrimination against small business borrowers based on race or sex. The new information that small business lenders must collect and report will give the government valuable information with which to select and prosecute targets.	
Model Forms for Federal Consumer Financial Laws		
The Act authorizes the CFPB to prepare model forms for the disclosures required under Federal Consumer Financial Laws. Model forms must be validated by the CFPB through consumer testing.	This will, at least initially, result in increased compliance costs as lenders implement new disclosures. The Act creates a safe harbor for using model forms.	The Designated Transfer Date
The Act requires the CFPB to propose rules to combine disclosures under the Federal Truth in Lending Act and the Real Estate Settlement Procedures Act.	The Federal Reserve Board and HUD have been trying to do this for many years. By giving the responsibility to the CFPB, the Congress increases the likelihood that it will get done.	Within 1 year of the Designated Transfer Date
Authority to Investigate Violations and Enforce Federal Consumer Financial Law		
The CFPB is given broad powers to investigate violations of Federal Consumer Financial Law by banks over $10 billion in assets and nondepository covered persons, including the power to issue subpoenas to compel testimony and require the production of documents, and the power to issue cease and desist orders. The CFPB may also initiate civil lawsuits to enforce Federal Consumer Financial Law.	Congress has provided the CFPB with the weapons to aggressively enforce compliance with Federal Consumer Financial Law. While the CFPB will not have the authority to investigate and bring enforcement actions against community banks, the stepped-up enforcement of Federal Consumer Financial Law against other	

Among the remedies available to the CFPB is the power to require the rescission or reformation of contracts, the refund of moneys or return of real property, the payment of damages, and the payment of civil money penalties from $5,000 to $1,000,000 per day. The CFPB does not have the authority to file criminal charges but can make referrals to the Department of Justice. In addition, the CFPB is required to make referrals to the Internal Revenue Service of potential violations of tax laws.	institutions will put pressure on a community bank's regulator to increase its enforcement efforts and the prosecution of other institutions by the CFPB will create precedent for bank regulators to follow in doing so.	
Consumer Complaint Unit		
The Act requires the CFPB to establish a unit to receive consumer complaints and to provide a timely written response to those complaints. The CFPB must establish a single toll-free telephone number, a website and a database to collect, monitor and respond to consumer complaints. The CFPB must report annually to Congress on consumer complaints.	The CFPB is expected to take a more aggressive approach to addressing consumer complaints than bank regulators currently do. Community banks should evaluate the effectiveness of the procedures for monitoring and responding to consumer complaints.	The Designated Transfer Date
Authority of State Attorney Generals to Enforce Regulations by the CFPB		
The Act allows state attorney generals to enforce regulations issued by the CFPB against state-chartered banks after consulting with the CFPB and the bank's regulator.	Michigan's Attorney General will have a new weapon in proceeding against nondepository companies, such as mortgage brokers, that provide consumer financial services. However, the Michigan Attorney General may also use that weapon in regulating state-chartered banks.	The Designated Transfer Date

State attorney generals may bring a civil action against a national bank or a federal savings bank to enforce any regulation of the CFPB (but not the Act itself) after consulting with the CFPB and the bank's regulator. The Act expressly allows a state to bring an action against a national bank or federal thrift to enforce other "applicable" law.	National banks and federal thrifts in Michigan may now be subject to suit by the Michigan Attorney General.	The Designated Transfer Date
Protection for Whistleblowers		
The Act protects employees against retaliation for providing information to any local, state, or federal authority regarding violations of the Act or any regulation under the Act. Other conduct, such as testifying against a bank or refusing to engage in activity the employee reasonably believes would violate any law within the jurisdiction of the CFPB, is also protected. Whistleblower complaints are investigated by the Secretary of Labor.	In light of the new whistleblower protections, community banks may wish to examine their policies and procedures to ensure that employees have an effective means of bringing violations of law to the attention of management.	The Designated Transfer Date
Limitations on Federal Preemption		
The Act limits federal preemption of state law to circumstances where the state law is inconsistent with federal law. A state law that is more protective of the consumer is not inconsistent and therefore is not preempted.	The Act allows states to have laws that are more protective than Federal Consumer Financial Law. This will impose a greater burden on interstate banks, which must comply with the laws of multiple states. But it will also create more uncertainty for state banks that have to determine whether state or federal law is more protective of consumers.	The Designated Transfer Date
The Act now provides that a state consumer financial law will be preempted from applying to national banks only if (a) the state law has a	The Comptroller of the Currency will be limited in its ability to preempt state laws affecting community banks with a national	The Designated Transfer Date

discriminatory effect on national banks as compared to the effect on state chartered banks, (b) the state law prevents or significantly interferes with the exercise by a national bank of its powers, or (c) the state law is preemption another provision of federal law. Subsidiaries of national bank and federal thrifts will no longer benefit from the federal preemption given to their parent depository institution, but instead will be subject to state consumer financial laws to the same extent that they apply to any other person or entity subject to the law of the state.	bank of federal thrift charter. Subsidiaries of those banks, such as mortgage companies, will be not be subject to preemption and will need to comply with state licensing and lending laws.	
Prohibited Payments to Mortgage Originators		
The Mortgage Reform Act prohibits a lender from paying, or a mortgage originator, including a loan officer or mortgage broker, from receiving, compensation that varies based on the terms of the loan (other than the amount of the principal). A lender may not pay, and a mortgage originator may not accept, an origination fee (other than bona fide third party charges that are not retained by the lender or the mortgage originator) if the lender knows, or has reason to know that the consumer has compensated, or will compensate, the mortgage originator.	The Mortgage Reform Act prohibits lender from paying a mortgage originator (other than its own employee) a yield spread premium on a loan.	Regulations must be prescribed in final form within 18 months after the Designated Transfer Date. The regulations must take effect not later than 12 months are the issuance of the regulations in final form. If regulations are not issued within 18 months after the Designated Transfer Date, the section shall become effective as of that date.
Required Determination of the Consumer's Ability to Repay		
Before making a mortgage loan, a creditor must make "a reasonable and good faith determination based	The ability to repay must be based on a payment schedule that fully amortizes the loan over the term of	Not later than 12 months after the issuance of regulations under the Mortgage Reform

on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance, and assessments." To determine ability to pay, the lender shall consider the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures the loan. The determination must be based on a payment schedule that fully amortizes the loan over the term of the loan.	the loan. If the property secures more than one loan, ability to repay must be based on repayment of all loan. This obligation raises the potential for litigation over whether a lender's determination was reasonable and made in good faith. The borrower may raise the lender's failure to accurately make the determination of ability to repay as an offset in an action by the lender to foreclose on a mortgage unless the loan was a Qualified Mortgage Loan.	Act.
The Mortgage Reform Act creates a presumption of ability to repay in the case of a "Qualified Mortgage Loan." A "**Qualified Mortgage Loan**" is a fully amortizing loan with no balloon payment that does not provide for negative amortization at any time and on which the APR does not exceed an average prime rate offer by certain tolerances. To be a Qualified Mortgage Loan, the points and fees in connection with the loan may not exceed 3 percent of the total loan amount.	By creating a safe harbor from liability regarding the determination to repay, Congress has incented lenders to offer standard mortgages without features, such as balloon payments, that have been important products in the mortgage lending portfolio. Lenders that offer mortgages other than Qualified Mortgage Loans take on an additional level of risk.	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
Prohibited Steering		

The Act requires the Federal Reserve Board to draft regulations that prohibit a mortgage originator, including a lender, from steering an applicant that qualifies for a Qualified Mortgage Loan to a residential mortgage loan that is not a Qualified Mortgage Loan. In addition, the regulations must prohibit a mortgage originator, including a lender, from (a) steering a consumer to a residential mortgage loan that the consumer lacks the ability to repay or that has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms), (b) mischaracterizing a consumers credit history or the residential mortgage loans available to the consumer, (c) mischaracterizing or allowing the mischaraterization of the appraised value of a residential mortgage loan that secures a loan, and (d) if unable to offer a consumer loan that is no more expensive than the loan for which a consumer qualifies, discouraging an applicant from seeking a residential mortgage loan from another mortgage originator.		Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
Debtor's Right of Offset		
A debtor can assert an offset in any foreclosure action (judicial or otherwise) for damages if a mortgage originator or lender violates the provisions of the Mortgage Reform Act that prohibit certain payments to mortgage originators or require a determination of the borrower's ability to repay the loan. The debtor may do this even if	The new right of offset will make foreclosure by advertisement more difficult by permitting borrowers to allege violations of the Mortgage Reform Act.	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.

the statute of limitations on the violation has run. If the mortgage loan is a Qualified Mortgage Loan, the borrower cannot assert ability to repay as a defense to foreclosure.		
New Appraisal Requirements for Higher-Risk Mortgages		
In connection with certain higher-risk mortgages to a consumer, the Mortgage Reform Act imposes new appraisal requirements, including among others requiring the appraiser to make a physical visit to the interior of the property. The consumer is entitled to receive one free copy of the appraisal. The Mortgage Reform Act requires a second appraisal by a different appraiser if the mortgage is a subprime mortgage made to finance the purchase of a residence if the seller purchased the dwelling at a lower price within 180 days of the proposed purchase. The Act imposes new requirements to assure the independence of appraisers.	Higher risk mortgages will become more costly because of the new appraisal requirements.	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
Prohibition on Financing Single Payment Credit Insurance		
The Mortgage Reform Act prohibits a creditor from financing single payment credit insurance, including debt cancellation insurance, in a residential mortgage loan or any extension of credit under an open end credit plan secured by the consumer's principal dwelling.		Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
Prohibition on Prepayment Penalties		
The Mortgage Reform Act prohibits prepayment penalties except on certain Qualified Mortgage Loans. To qualify for this exception, a	The Mortgage Reform Act will restrict the ability of a community bank to recover its costs of making a loan in the event the loan is	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.

Qualified Mortgage Loan cannot be an adjustable rate loan or have an APR in excess of certain tolerances. Prepayment penalties on a qualifying Qualified Mortgage Loans are capped during the first three years and prohibited in subsequent years. The prepayment penalty may not exceed 3 percent of the outstanding loan balance in the first year, 2 percent in the second year, and 1 percent in the third year. If a creditor offers a loan with a prepayment penalty, it must also offer a loan without such a penalty.	repaid. This could increase the initial cost of credit, as lenders seek to recover their costs in up front fees.	
Additional New Disclosures		
The Mortgage Reform Act requires a new disclosure in a variable rate mortgage loan with a fixed introductory period. The lender must provide advance notice when the rate is about to reset.	Lenders will need to establish new procedures to provide the required disclosures.	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
The Mortgage Reform Act amends Truth in Lending to provide new disclosures if an open or closed end loan secured by a dwelling or residential real property allows for negative amortization.	Lenders will need to establish new procedures to provide the required disclosures.	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
Before making or refinancing a residential mortgage loan, the Mortgage Reform Act requires a lender to provide notice to the consumer regarding the protections of any applicable state law that provides that a consumer is not liable for any deficiency in the foreclosure of a mortgage loan.	This requirement will not apply in Michigan. Michigan law does not provide protection against deficiencies.	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
Changes in Definition for HOEPA Loans		

The Mortgage Reform Act lowers the pricing levels that trigger the applicability of the Home Ownership and Equity Protection Act ("HOEPA"). HOEPA will apply if: (a) the credit is secured by a first mortgage in the consumer's principal dwelling and the APR exceeds the "average prime offer rate" on comparable transactions (as reported by the Federal Reserve Board) by more than 6.5 percentage points (8.5 percentage points if the dwelling is personal property and the transaction is for less than $50,000), or (b) the credit is secured by a junior mortgage and the APR exceeds the average prime rate offer by more than 8.5 percentage points, or	Lenders will need to implement changes to its policies and procedures to address the changes in the applicability of HOEPA.	Not later than 12 months after the issuance of regulations under the Mortgage Reform Act.
(c) the total points and fees payable in the transaction, other than bona fide third party charges not retained by the mortgage originator or creditor exceeds 5 percent of the total transaction if the transaction is for $20,000 or more or, if the transaction is for less than $20,000, the lesser of $8 of the total transaction or $1,000, or (d) the credit documents permit the creditor to take prepayment fees more than 36 months after the transaction closes or such fees total more than 2 percent of the amount prepaid. The Mortgage Reform Act also		

expands the definition of points and fees for purposes of the HOEPA calculation.		
Applicant's Right to Get Copy of Credit Score		
The Dodd-Frank Act amends the Fair Credit Reporting Act to require a lender that takes an adverse action on an application to give the consumer the consumer's numerical credit score and the factors that affected the score if the lender relied in part on the credit score in taking the adverse action.		The Designated Transfer Date
Expansion of Truth in Lending Coverage and Extension of Statute of Limitations		
The Act increases the coverage of Truth in Lending to include credit transactions and consumer leases up to $50,000 rather than the current $25,000. The Act amends the Truth in Lending Act to double the civil penalties under the act. It also extends from 1 year to 3 years the statute of limitations that would bar the federal government from suing for a violation of TILA.	The number of loans and leases that are subject to the requirements and penalties of Truth in Lending will increase. Many community banks in Michigan already provide Truth in Lending disclosures for loans in excess of $25,000, but now they will be subject to penalties for violation, which have been doubled.	The Designated Transfer Date
Regulation of Interchange Fees and Payment Card Networks		
The Act gives the Federal Reserve Board the authority to regulate debit card interchange fees to require them to be both "reasonable and proportional" to the costs of the debit card issuer.	Banks that, together with their affiliates, have under $10 billion in assets are exempted. But many community banks are concerned that competitive pressures will require them to adhere to the limits placed on larger institutions, reducing the revenue community banks receive from debit card interchange fees.	12 months after enactment of the Dodd-Frank Act. The Federal Reserve Board must prescribe regulations in final form within 9 months of enactment.
The Federal Reserve Board is		The Federal Reserve Board

required to write regulations that prohibit a payment card issuer or network from requiring electronic debit transactions to be processed exclusively on one network or two or more affiliated networks.		must prescribe regulations within 12 months of enactment of the Dodd-Frank Act.
The Act prohibits a payment card network from prohibiting a merchant from providing a discount or in-kind incentive for payment by cash, check, debit card, or credit card so long as the discount or incentive does not differentiate on the basis of the issuer or the payment card network, is offered to all prospective buyers, and is disclosed clearly and conspicuously.		
The Act also prohibits a payment card network from forbidding a merchant from setting a minimum transaction of not more than $10 for accepting a credit card.		

If you have questions regarding the Dodd-Frank Act and its impact on Community Banks, please contact a member of the Financial Services Group at Warner Norcross & Judd.