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The CFPB Stays Busy This Summer

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Table of Contents:

- NAIC Provides Helpful Guidance on the Accounting Treatment for Insurance Company Investments in CRTs
- CFPB Issues Report on Concerns Regarding the Solar Financing Market
- CFPB Updates on Buy Now, Pay Later Lending
- CFPB Addresses “Contracts for Deeds,” a Mortgage-Like Product That Has Recently Gained Popularity

NAIC Provides Helpful Guidance on the Accounting Treatment for Insurance Company Investments in CRTs

August 22, 2024

By Christopher Horn
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At its Summer National Meeting in Chicago (August 12-15, 2024), the NAIC announced important guidance relating to the statutory accounting treatment of insurance companies' investments in bank credit risk transfer ("CRT") transactions.

Under the guidance, which is in the form of a **Q&A**:

- Although the new principles-based bond definition (SSAP No. 26) refers to ABS as being repaid with cash flows produced by collateral "owned" by the issuer, "*[t]he term 'owned' as used for this purpose is not necessarily intended to align with a legal view of ownership, but rather, all economic value to which the creditor has recourse*."
- Although the new bond definition requires a "creditor relationship" which generally requires that interest and principal payments do not vary based on a "non-debt variable," "*an ABS Issuer that owns derivatives in the structures (such as a credit default swap or total return swap) that solely transfers the performance of the referenced pool into the ABS structure does not automatically disqualify ABS classification, but the assessment of derivatives within a structure must be closely considered*."

Although this guidance is not authoritative and remains subject to public comment and subsequent change, it is helpful in providing assurance that CRTs can qualify for bond treatment.

Some further background:

What is the new principles-base definition of "bond"?

- Under **SSAP No. 26**, which was issued on August 13, 2023, and takes effect on January 1, 2025, a bond is defined as: "any security representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security as described in this statement."
- New SSAP No. 26 is the culmination of a four-year project to develop a definition of "bond" that is principles-based and that focuses on substance, rather than legal form.

Why is it important to an insurance company that an investment be treated as a "bond" under statutory accounting principles ("SAP")?

- *Lower RBC Charge*. Bonds receive lower risk-based capital charges than other types of securities (*e.g.*, common stock). Risk-based capital charges for bonds held by insurance companies are based on the credit quality designation that the NAIC assigns.
- *Not Marked-to-Market*. Under SAP, bonds do not have to be marked to market on the insurance company's balance sheet. Rather, bonds are reported at amortized cost as long as they are above the lowest credit quality designation, NAIC-6.

What are statutory accounting principles (SAP)?

- Insurers authorized to do business in the United States and its territories are required to prepare statutory financial statements in accordance with **statutory accounting principles ("SAP")**, not generally-accepted accounting principles ("GAAP").
- SAP are detailed within the NAIC Accounting Practices and Procedures Manual ("AP&P Manual"). The AP&P Manual contains the Statements of Statutory Account Principles ("SSAPs").
- The Statutory Accounting Principles ("E") Working Group ("SAPWG") is responsible for developing and adopting revisions to the AP&P Manual. SAPWG is a working group of the Accounting Practices and Procedures ("E") Task Force, which is a task force that reports to the NAIC's **Financial Condition ("E") Committee**.

What is the NAIC?

- In the United States, insurance is regulated primarily at the state level. The **National Association of Insurance Commissioners ("NAIC")** plays a coordinating role. The NAIC is a standard setting organization governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories to coordinate regulation of multistate insurers.
- The NAIC delegates its work to various committees, including the Financial Condition ("E") Committee. That committee is the central forum and coordinator of solvency-related considerations of the NAIC relating to, among other things, accounting practices and procedures, and the valuation of securities.

CFPB Issues Report on Concerns Regarding the Solar Financing Market

August 22, 2024

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In **this report on the solar financing marketplace**, which is characterized as an "Issue Spotlight", the CFPB identifies four areas that they view to present risks to consumers. In the **press release** accompanying the report, Director Rohit Chopra commented, "With sweltering heat across America this summer, many families are installing solar panels to save on energy costs to cool their home, the CFPB is closely scrutinizing solar lenders to make sure that Americans don't get burned."

We leave it to the reader to decide whether anyone really thinks about installing solar panels specifically to cool off their homes.

The four areas of concern identified by the CFPB are as follows, each of which should be taken into consideration by participants in this marketplace to ensure that their programs, disclosures and processes do not trip on them:

1. **Hidden markups and fees**. The CFPB identifies "dealer fees" as being baked into the loan principal and therefore constituting "hidden" fees. To the CFPB, "dealer fees" are "a markup from the total cash price that consumers pay for the system installation." Should dealer fees appear in financing, it is important to understand what those fees represent and to ensure that the system installation through financing will have the same base price as system installation paid for by cash.
2. **Misleading statements concerning federal tax credits**. Emphasizing that the federal "Investment Tax Credit" is not a guarantee because it "depends on the consumer's federal tax liability" (i.e., "[l]ow-income consumers are less likely to receive a tax credit'). The CFPB specifically highlighted being concerned about marketing materials that "deduct" the presumed tax credit from sample loan costs and then present a "net cost" for the system.
3. **Misrepresentations and omissions concerning "voluntary" prepayments**. The CFPB observes that many solar loans are structured such that borrowers have to pay a large share of the loan principal (30% is referenced) by a certain time, regardless of their minimum monthly payment amounts, to avoid having the monthly payment amount increase. To the extent solar loans are structured in this manner, it is important to ensure that consumers understand the timing of the monthly payment increase and the circumstances under which the monthly payment may not increase (e.g., because the required amount of principal has been paid or due to set-offs from tax credits).
4. **Misrepresentations regarding financial benefits**. Although the CFPB acknowledges that "households can generate substantial savings from solar energy installation", they emphasize the need to ensure that any statements regarding such savings be properly substantiated and include clear and conspicuous warnings that a variety of factors may lead to significant variations in actual savings.

While reminding that the CFPB **proposed rules** last summer to "rein in abuses" on PACE and is working on finalizing them, the CFPB also released a **consumer advisory** "warning homeowners of the risky practices in the solar lending market and sharing advice for borrowers who encounter illegal activity." Among the advice provided, consumers are suggested to spend money on an "independent energy audit" before investing in energy-efficient appliances, taking steps to weatherize the home or solar energy systems and to present that auditor with any proposals received that include the cash price of the items/services, a written breakdown of the work to install the items and the actual materials that will be installed. The "auditor can go over the proposals with you, to help you choose."

CFPB Updates on Buy Now, Pay Later Lending

August 22, 2024

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On August 16th, the Consumer Financial Protection Bureau ("CFPB") Director, Rohit Chopra, published a blog post entitled “What Buy Now, Pay Later lenders are doing to be upfront with borrowers” that follows up on its proposed so-called “Interpretive Rule” addressing the “**Use of Digital User Accounts to Access Buy Now, Pay Later Loans**”, issued in May. The proposed Interpretive Rule provided guidance to the Buy Now, Pay Later ("BNPL") industry regarding how to apply Regulation Z-style disclosures and consumer rights to BNPL transactions, but also extended the definitions of “card issuer” and “creditor” to BNPL providers.

The comment period for this rule ended August 1st, but the CFPB stated that the rule became effective on July 30th, thereby signaling that the request for comments on the rule was effectively pro forma. The CFPB’s rule joins **guidance published by the Office of the Comptroller of the Currency this past December** that provided guidance to its banks regarding managing risks related to BNPL in a safe and sound manner. The OCC was concerned that borrowers could over-extend themselves or not fully understand BNPL repayment obligations and that there was a lack of clear, standardized language so that consumers could understand the true nature of the transaction. They also highlighted concerns regarding merchandise returns and merchant disputes, because BNPL transactions are not covered by the same error resolution and dispute rights that consumers have with respect to their debit card and credit card transactions. Please see our coverage of these BNPL developments **here**. Given the Supreme Court decision overruling Chevron, it will be interesting to see the extent to which any court gives deference to the CFPB’s enforcement of its Interpretive Rule, especially in its original, pre-comment period form.

In an unusually ingratiating tone, Director Chopra comments in the blog that the BNPL industry is “responding favorably and constructively” to the Interpretive Rule and that the participants “are working diligently and in good faith to come into compliance.” Accordingly, the post announces that the CFPB will be publishing a set of Frequently Asked Questions and states that “the CFPB does not intend to seek penalties for violations of the rules [while a BNPL lender] is transitioning into compliance in a good faith and expeditious manner” and that they “expect that other federal and state regulators will follow the same path.”

CFPB Addresses “Contracts for Deeds,” a Mortgage-Like Product That Has Recently Gained Popularity

August 22, 2024

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On August 13th, the Consumer Financial Protection Bureau (“CFPB”) published a **consumer advisory** as well as an **advisory opinion** addressing “contracts for deeds”, which are also variously called a “bond for deed”, “land installment contract” or “buying on contract.” Basically, with these products the purchase of a residential property is made pursuant to an installment plan with payments being made directly to the seller. So instead of going to a bank or mortgage lender to get a traditional mortgage loan, the buyer and seller enter into a private transaction. As the CFPB states, “As the buyer under a contract for deed, you must act as the property owner during the term of the contract, even though the deed is not yours yet. In a typical contract for deed, property taxes, insurance, repairs, and maintenance are paid by the buyer.”

Noting that federal and state laws provide limited protections, the consumer advisory tells consumers that they can “choose to file the contract with the state or local office in charge of land records” which will entitle them “to receive notices about the property, such as when the deed is transferred to another owner, a mortgage is taken out on the property, or a lien is filed.”

Meanwhile, the advisory opinion sets out arguments as to why these kinds of transactions are “credit” under the Truth In Lending and Regulation Z – “in a typical contract for deed transaction . . . a debt is created by the buyer receiving exclusive possession of the property, along with certain ownership obligations, at the outset of the contract in exchange for the obligation to repay the agreed-upon value of that property over time.” Then, the opinion argues that contracts for deeds are “residential mortgage loans” under TILA and Regulation Z – “Congress defined ‘residential mortgage loan” to include ‘any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential rea property that includes a dwelling.” The argument for why a contract of deed is a residential mortgage loan is a bit tortured, with the CFPB having to reference Black’s Law Dictionary definitions and an assortment of individual state laws to support it.

But, the upshot of the advisory opinion is that contracts for deeds should comply with all consumer rights and disclosures that apply to residential mortgage loans, as described in TILA and Regulation Z, including high-cost mortgage provisions, including HOEPA requirements and protections.