ALERTS

Recent CFPB Mortgage Rules To Absorb And Implement

January 30, 2013 | Atlanta | Chicago | Columbus | Delaware | Elkhart | Fort Wayne | Grand Rapids | Indianapolis | Los Angeles | Minneapolis | South Bend

January 2013 was a very busy month for the Consumer Financial Protection Bureau in promulgating rules relating to consumer mortgage lending. The CFPB promulgated seven rules pertaining to consumer mortgage lending during January 2013:

- Ability to Repay (ATR) and Qualified Mortgage (QM) Standards under TILA/Regulation Z
- Escrow Requirements for Higher-Priced Mortgages Under TILA/Regulation Z
- High-Cost Mortgage and Homeownership Counseling Amendments to TILA/Regulation Z and Homeownership Counseling Amendments to RESPA/Regulation X
- RESPA/Regulation X and TILA/Regulation Z Mortgage Servicing
- Appraisals for Higher-Priced Mortgage Loans (issued jointly with other agencies)
- Disclosure and Delivery Requirements for Copies of Appraisals and Other Written Valuations Under ECOA/Regulation B
- Loan Originator Compensation Requirements Under TILA/Regulation Z

With so many new CFPB rules, there is much to be learned and absorbed by loan originators, mortgage brokers, mortgage lenders, and mortgage servicers between now and the dates on which such rules will go into effect. With the exception of the High-Cost Mortgage and Homeownership Counseling Amendments to TILA/Regulation Z, the Homeownership Counseling Amendments to RESPA/Regulation X and the Escrow Requirements for Higher-Priced Mortgages rule, which will go into effect on June 1, 2013, and certain limited provisions contained in the Loan Originator Compensation rule, which will also go into effect on June 1, 2013, all of these rules have effective dates in January 2014, one year after their respective promulgation dates.

Although each of these rules is important and poses certain compliance challenges, we will summarize in this Alert two of the most significant rules (largely due to their very widespread applicability and their overall complexity). These are (1) the ATR and QM Standards rule; and (2) the Loan Originator Compensation rule.

ATR and QM Standards

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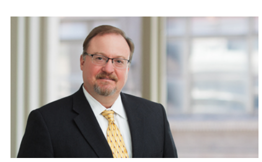

The ATR and QM Standards rule, together with accompanying preamble, explanations and commentary, is over 800 pages long. The rule, among other things, implements a Dodd-Frank Act amendment to TILA requiring a consumer mortgage creditor, before originating a mortgage loan, to consider the borrower's ability to repay. The new rule allows a creditor to satisfy this requirement by: (1) satisfying the general ATR standards, which would require the creditor to consider eight different and discrete factors relating to the borrower's ability to repay (generally using reasonably reliable third-party records to verify the information considered); (2) refinancing a "non-standard mortgage" into a "standard mortgage"; (3) originating a "rural balloon-payment QM" if, but only if, the creditor qualifies under a rigorous standard under which few creditors would qualify (creditors must have less than $2 billion in assets, must originate no more than 500 first-lien mortgages, and must originate at least 50 percent of the first-lien mortgages in counties that are rural or underserved); or (4) originating a QM.

The advantage of meeting the QM standards is that, in general, the creditor will obtain an irrebuttable presumption of the borrower's ability to repay the mortgage, which would block most lawsuits. However, if the mortgage is a "higher-priced mortgage," the creditor obtains only a rebuttable presumption of the borrower's ability to repay the mortgage, which makes such loans more easily challenged in court. A "higher-priced mortgage" is one which is priced 1.5 percentage points higher than a comparable loan in Freddie Mac's Primary Mortgage Market Survey. This distinction will likely make "higher-priced mortgages," or so-called subprime loans, less available. In this regard, some pundits have predicted that, in the future, only mortgages meeting the QM standards and that are not "higher-priced mortgages" or "high-cost mortgages" will be generally available.

To qualify as a QM the mortgage loan must satisfy the following standards:

- provide for regular periodic payments that are substantially equal (except for ARMs and step-rate loans) that do not result in negative amortization or allow the borrower to defer repayment of principal, or result in a balloon payment (except for balloon-payment QMs);
- have a term no greater than 30 years;
- have total points and fees that do not exceed the permitted percentage of the loan amount (which is generally three percent (3%), subject to a few exceptions and refinements);
- be underwritten taking into account the monthly payment and any mortgage related obligations, using the maximum interest rate that may apply during the first five years and periodic payments that will repay either (i) the outstanding principal and interest over the remaining term of the loan after the interest rate adjusts to the five-year maximum or (ii) the loan amount over the loan term;
- for which the creditor considers and verifies the income or assets, and current debt, alimony, and child support obligations; and
- for which the consumer's debt-to-income ratio does not exceed forty-three percent (43%) when the loan is consummated.

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Notwithstanding these stringent QM standards, on a temporary basis, and for a period not to exceed a maximum of seven years, the CFPB created a second category of QMs that meet some, but not all, of the general QM standards. Simply stated, to qualify under this second category, the loan must meet the general product feature prerequisites for a QM and also satisfy the underwriting standards for purchase, guaranty, or insurance (as applicable) of either (i) the GSEs, as long as they operate under Federal conservatorship or receivership, or (ii) HUD, the VA, the USDA, or the Rural Housing Service.

This rule also implements a provision of the Dodd-Frank Act that prohibits prepayment penalties, except for certain fixed-rate QMs where the penalty meets certain restrictions and the creditor offered the consumer an alternative mortgage loan without the penalty.

Loan Originator Compensation

In connection with the CFPB's new Loan Originator Compensation rule, the CFPB published over 500 pages of background and prefatory material, explanations, and commentary. In this rule, the CFPB both expands and clarifies existing provisions in Regulation Z regulating loan originator compensation. Many, if not most, of the provisions in the final rule have substantially identical counterparts in current Regulation Z § 1026.36(d) and the related Official Staff Commentary.

However, the final rule has expanded treatment regarding the prohibited use of "proxies" for a term of a transaction in awarding loan originator compensation. In this regard, the final rule clarifies the definition of a proxy as a factor that consistently varies with a transaction over a significant number of transactions, and the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating the transactions.

While retaining current Regulation Z's general prohibition against subsequent downward adjustments to a loan originator's compensation based upon changes in the transaction terms (e.g., to match or better the terms of a competitor), the final rule, unlike current Regulation Z, allows loan originators to reduce their compensation to defray certain unexpected increases in estimated settlement costs.

Although the final rule generally prohibits loan originator compensation based upon the profitability of a transaction or a pool of transactions, it makes certain limited exceptions to this general rule with respect to various kinds of tax-advantaged retirement plans and other profit-sharing plans. In this regard, mortgage-related business profits can be used to make contributions to certain tax-advantaged retirement plans and to provide bonuses and contributions to other plans that do not exceed 10 percent of the individual loan originator's total compensation (but employers can elect whether or not to include contributions to tax-advantaged retirement plans in the "total compensation" calculations).

Regulation Z currently provides that, where a loan originator receives compensation directly from a consumer in connection with a covered mortgage loan, no loan originator may receive compensation from another person in connection with the same transaction. The Official Staff Commentary to current Regulation Z indicates, however, that this prohibition does not prohibit the employer of a loan originator from paying such loan originator a salary or an hourly wage in that instance. As a pleasant surprise, the final rule permits mortgage brokers to pay their employees or independent contractors a commission on the particular mortgage loan, so long as the commission is not based upon the terms of such mortgage loan.

The CFPB has elected not to issue a rule implementing a provision of the Dodd-Frank Act prohibiting consumers from paying upfront points or fees on a transaction if the loan originator's compensation is paid by a person other than the consumer (either to the creditor's own employee or to a mortgage broker). Instead, the CFPB elected to grant a temporary exemption from this prohibition while it explores the potential effects of such a prohibition.

The final rule also contains some provisions unrelated to loan originator compensation. Specifically, in furtherance of other provisions in the Dodd-Frank Act, the final rule (1) prohibits mandatory arbitration clauses in connection with both residential mortgage loans and HELOCS; (2) prohibits the application or interpretation of provisions in residential mortgage loans and HELOCS and related agreements that would have the effect of barring claims in a court in connection with an alleged violation of Federal law; and (3) prohibits the financing of any premiums or fees for credit insurance (such as credit life insurance) in connection with a consumer credit transaction secured by a dwelling (but allows for credit insurance to be paid on a monthly basis). These are the only provisions of the final rule which have a June 1, 2013, effective date.

Other provisions in the final rule address (1) the additional obligations imposed on depository institutions in ensuring that their loan originator employees meet character, fitness, and criminal background standards similar to existing SAFE Act licensing standards and are properly trained; and (2) expanded recordkeeping requirements pertaining to loan originator compensation applicable to both creditors and mortgage brokers.

Recess Appointment of Richard Cordray

The Jan. 25, 2013 decision of the D.C. Circuit Court of Appeals invalidating recess appointments to the National Labor Relations Board, calls into question the recess appointment of Richard Cordray as head of the CFPB. What impact this potentially invalid appointment will have on the CFPB regulations promulgated in January 2013 is undetermined at this time.

For more information about the various CFPB rules mentioned or summarized in this ALERT or the other CFPB rules promulgated recently, contact the Barnes & Thornburg attorney with whom you have a relationship or one of the following attorneys in the firm's Financial Institutions Practice Group.

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