Lenders Compliance Group

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CFPB's Gang of Seven (Final Rules)

This has been a busy month for the Consumer Financial Protection Bureau (CFPB). Since the advent of the New Year, the CFPB has issued seven Final Rules that impact residential mortgage loan originations.

The finale was on Sunday, January 20, 2013, when the CFPB issued the seventh Final Rule, one day prior to the deadline set forth in the Dodd-Frank Act (Dodd-Frank), in § 1400(c), for automatic implementation of its Title XIV provisions.

By my count, these are the Final Rules, in order of their issuance:

1. Ability-to-Repay (ATR)
2. High-Cost Mortgage (HCM)
3. Escrow
4. Servicing
5. Appraisals for High-Risk Mortgages
6. Copies of Appraisals
7. Mortgage Loan Originator Compensation

I recently discussed the Final Rule regarding the Ability-to-Repay. I will soon provide an outline of the CFPB's important Final Rule for Mortgage Loan Originator Compensation.

With regards to the latter, we will be updating the FAQs Outline - Loan Originator Compensation for the rule changes affecting loan origination compensation. For your consideration, I plan to provide soon a useful and practical understanding of the compensation revisions. In the near future, I will notify you of and provide access to the forthcoming article I am publishing on these regulatory guidelines.

In this article, I want to briefly outline this **Gang of Seven (Final Rules).** Please keep in mind that I am providing a broad sketch of the Final Rules. As is the case with many applications of legal and regulatory compliance, there are numerous statutory requirements and implementation guidelines that bring about consideration of some recourse to a competent risk management professional.

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Chart: Final Rules - Compliance Dates

Let's start first with a chart of the Final Rules and their respective compliance effective dates. I realize that there is considerable interest in the RESPA/TILA integration of mortgage disclosures; however, on November 16, 2012 the CFPB published a Final Rule exempting persons from complying with twelve specified Title XIV mortgage disclosure requirements. The RESPA/TILA disclosure integration is now scheduled for completion in September 2013. Without the aforementioned exemption, these twelve disclosure requirements would actually have taken effect on January 21, 2013.

CFPB's 7 Final Rules – January 2013 – Mortgage Compliance

Final Rule	Compliance Date
Ability-to-Repay	January 10, 2014
High-Cost Mortgage	January 10, 2014
Escrow	June 1, 2013
Servicing	January 10, 2014
Appraisals for HPMLs	January 18, 2014
Copies of Appraisals	January 18, 2014
Mortgage Loan Originator Compensation	January 10, 2014 Except June 1, 2013 for provisions regarding mandatory arbitration and the financing of single-premium credit

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Chart deals with only the Gang of Seven (Final Rules).

Gang Member # 1: Ability-to-Repay (ATR)

First an observation: the CFPB apparently was not able to finalize this entire regulation by the deadline of January 21, 2013, so it seems to have postponed issuing a more comprehensive final rule, which it intends to further "finalize" before the compliance effective date of January 10, 2014.

Dodd-Frank provides the authority to the CFPB to define criteria for certain loans called the "Qualified Mortgage" (QM) that are presumed to meet the Ability-to-Repay rule requirements.

There are four (4) ATR components, each in its own way requiring the lender to obtain and verify financial information from the loan applicant.

The CPFB asserts that a QM prohibits or limits the "risky features that harmed consumers in the recent mortgage crisis." Therefore, lenders will be presumed to have complied with the Ability-to-Repay rule if they issue Qualified Mortgages.

There are four (4) component features to the QM.

And there are two (2) types of QMs, each of which differ with respect to legal and regulatory consequences: Qualified Mortgages with Rebuttable Presumption, and Qualified Mortgages with Safe Harbor.

Read the article on Ability-to-Repay and the Qualified Mortgage (QM).

Gang Member # 2: High-Cost Mortgage (HCM)

Dodd-Frank promulgated the high-cost mortgage (HCM) provisions of Regulation Z (otherwise known as HOEPA or Section 32 Loans) as well as new homeownership counseling provisions. Under the Final Rule, HCMs cover most types of mortgage loans secured by a consumer's principal dwelling (excluding reverse mortgages, initial construction loans, housing finance agency loans, USDA's Section 502 loans). The HCM provisions revise the so-called "coverage tests" (i.e., APR, points and fees, prepayment penalties).

This regulation implements the following requirements:

(1) Prohibits prepayment penalties and balloon payments, with limited exceptions for certain types of loans made by creditors serving rural or underserved areas;

(2) Prohibits fees for modifying loans, caps late fees at four (4%) percent of the past due payment, bans closing costs from being rolled into the loan amount, restricts the charging of payoff statement fees, and prohibits certain other practices, such as encouraging a consumer to default on an existing loan to be refinanced by an HCM;

(3) Requires consumers to receive homeownership counseling before taking out an HCM; and,

(4) Mandates HELOC creditors to assess ability to repay.

With respect to counseling, the regulation further requires lenders to provide a list of homeownership counseling organizations to consumers shortly after they apply for a mortgage loan (not just an HCM) and implements a new requirement that creditors obtain confirmation of homeownership counseling from first-time borrowers on loans permitting negative amortization (not just HCMs).

Gang Member # 3: Escrow

The revised regulation:

(1) Amends existing Regulation Z provisions that require creditors to establish and maintain escrow accounts for at least one year after originating higher-priced mortgage loans (HPMLs) to generally require that the accounts be maintained for five years;

(2) Establishes an exemption for small creditors that operate predominantly in rural or under-served areas. Specifically, this exemption is offered to a creditor that makes more than half of its first-lien mortgages in rural or underserved areas, has less than $2 billion in assets, together with affiliates has generated 500 or fewer first-lien mortgages during the preceding calendar year, and, including its affiliates, generally does not escrow for any mortgage; and,

(3) Provides an exemption from escrowing for insurance premiums for condominium units to other situations in which an individual consumer's property is covered by a master insurance policy. Under the rules, eligible creditors need not establish escrow accounts for mortgages intended at consummation to be held in portfolio, but must establish escrow accounts at consummation for mortgages subject to forward commitments with an investor that does not itself qualify for the small creditor exemption.

Gang Member # 4: Servicing

This regulation mandates that servicers must:

(1) Correct errors asserted by mortgage loan borrowers;

(2) Provide certain information requested by borrowers;

(3) Implement various protections in connection with force-placed insurance;

(4) Establish reasonable policies and procedures regarding delineated objectives (i.e., delinquent mortgage loans);

(5) Requires dispensing information about mortgage loss mitigation options to delinquent borrowers;

(6) Introduces a policies and procedures requirement for providing borrowers with "continuity of contact" with servicer personnel capable of performing certain functions; and,

(7) Requires the servicer to evaluate a borrower's application for available loss mitigation options.

Note: There are revisions to already existing servicing regulations, such the requirement that servicers must provide disclosures regarding transfers of mortgage servicing as well as the specifics of managing escrow accounts. That said, the Final Rule also mandates a clear text in the monthly mortgage statements, early warnings before interest rates adjust, prompt crediting of payments, and prompt responses to requests for payoff amounts.

Gang Member # 5: Appraisals for High-Risk Mortgages

This regulation implements requirements pertaining to appraisals for high-risk mortgages (HRMs). The HRMs, as a matter of nomenclature, effectively replace the existing rules governing appraisals for "higher-priced mortgage loans" (HPMLs). The Final Rule permits a creditor to extend an HRM *qua* HPML only if (1) the creditor obtains a written appraisal, (2) the appraisal is performed by a certified or licensed appraiser, and (3) the appraiser conducts a physical visit to the interior of the property.

At the time of application, the consumer must be given a specific notice that (1) states the purpose of the appraisal, that (2) the creditor will provide the applicant a copy of any written appraisal, that (3) the creditor may charge the applicant for the appraisal, and that (4) the applicant may choose to have a separate appraisal conducted at his or her own expense.

In addition to the foregoing, the creditor must provide the consumer with a free copy of any written appraisals at least three business days before consummation.

Where the seller acquired the home within 180 days before the date of the consumer's purchase agreement and the consumer is paying a price that exceeds the seller's acquisition price by 10 percent if the seller acquired the property within the past 90 days or exceeds the seller's acquisition price by 20 percent if the seller acquired the property between 91 and 180 days earlier, the creditor must obtain a second written appraisal based on an interior inspection of the property, at no cost to the consumer. Generally, these criteria are contained with the definition of "flipped" properties.

Note: The regulation exempts qualified mortgages, reverse mortgages, temporary bridge loans (i.e., 12 months or less), loans secured by manufactured homes, and transactions secured by mobile homes, boats, or trailers.

Gang Member # 6: Copies of Appraisals

This Final Rule amends Regulation B, the implementing regulation of the Equal Credit Opportunity Act. Creditors are required to provide free copies of appraisal and valuation reports prepared in connection with any closed-end loan secured by a first lien on a dwelling and, in certain situations, requires second appraisals.

For a first lien on a dwelling:

(1) Creditors must notify applicants within three business days of receiving an application of their right to receive copies of any appraisals;

(2) Creditors must provide applicants with copies of each appraisal and other written valuation promptly upon completion or three business days before consummation (for closed-end credit) or account opening (for open-end credit), whichever is earlier;

(3) Applicants may waive the timing requirement for providing these copies, but creditors still must give consumers copies of all appraisals and valuations at or before consummation or account opening or, if the transaction is not consummated or account not opened, no later than 30 days after the creditor determines that the transaction will not be consummated or the account not opened; and,

(4) Creditors may not charge for copies of appraisals and other written valuations, but they are permitted to charge "reasonable fees" for the cost of the appraisals or valuations (unless applicable law provides otherwise).

Gang Member # 7: Mortgage Loan Originator Compensation

Finally, the CFPB issued the Final Rule regarding mortgage loan originator compensation, further amending Regulation Z (the implementing regulation of the Truth in Lending Act). The Final Rule addresses (1) the qualifications of, and registration or licensing of, loan originators, (2) compliance procedures for depository institutions, (3) mandatory arbitration provisions, and (4) the financing of single-premium credit insurance.

The Final Rule provides additional Staff Commentary on Regulation Z's restrictions on loan originator compensation, including the application of those restrictions to prohibitions on dual compensation and compensation based on a term of a transaction or proxy for a term of a transaction.

The rule also establishes new tests for when loan originators may be compensated through profit-based compensation arrangements.

Importantly, the CFPB discarded for the time being its proposed plan to prohibit payments to and receipt of payments by loan originators when a consumer pays upfront points or fees.

Let's take a closer look at this Final Rule.

Essentially, the regulation contains these salient elements:

- Prohibition against compensation based on a term of a transaction or proxy for a term of a transaction.
- Prohibition against dual compensation.
- No prohibition on consumer payment of upfront points and fees.
- Loan originator qualification and identifier requirements.
- Prohibition on mandatory arbitration clauses and single premium credit insurance.

I offer hereinafter a brief description of each of the aforementioned elements.

Prohibition against compensation based on a term of a transaction or proxy for a term of a transaction.

The Final Rule defines "a term of a transaction" as "any right or obligation of the parties to a credit transaction." This means, for instance, that a mortgage broker employee cannot receive compensation based on the interest rate of a loan or on the fact that the loan officer steered a consumer to purchase required title insurance from an affiliate of the broker, since the consumer is obligated to pay interest and the required title insurance in connection with the loan.

As the case has been to date, in order to "prevent evasion" there is a prohibition on compensation based on a "proxy" for a term and condition of a transaction. Clarification is now provided to defining a factor determinant of a proxy, such a determinant to focus on whether (1) the factor consistently varies with a transaction term over a significant number of transactions, and (2) the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating the transaction.

With respect to the prohibition on reducing loan originator compensation to offset the cost of a change in transaction terms (viz., "pricing concession"), the Final Rule now allows loan originators to reduce their compensation to defray certain unexpected increases in estimated settlement costs.

The "up-charge" prohibition, meant to disincentivize loan originators from "up-charging" consumers on their loans, has been kept in the Final Rule since any such compensation is based upon the profitability of a transaction or a pool of transactions. However, the Final Rule now narrows this prohibition to various kinds of retirement and profit-sharing plans. (The example given in the Final Rule is where "mortgage-related business profits can be used to make contributions to certain tax-advantaged retirement plans, such as a 401(k) plan, and to make bonuses and contributions to other plans that do not exceed ten percent of the individual loan originator's total compensation.")

Prohibition against dual compensation.

Under the already established provisions in Regulation Z, where a loan originator receives compensation directly from a consumer in connection with a mortgage loan, no loan originator may receive compensation from another person in connection with the same transaction. This is the prohibition on so-called dual compensation. The Final Rule also implements this restriction; however, it provides an exception to allow mortgage brokers to pay their employees or contractors commissions, although, of course, the commissions cannot be based on the terms of the loans that they originate.

No prohibition on consumer payment of upfront points and fees.

One area of Dodd-Frank, specifically Section 1403, has presented quite a bit of controversy since its inception. In that section of Dodd-Frank, consumers are prohibited from paying upfront points or fees on transactions in which the loan originator compensation is paid by a person other than the consumer (either to the creditor's own employee or to a mortgage broker). Nevertheless, Dodd-Frank did authorize the CFPB to waive or create exemptions from the prohibition on upfront points and fees if it determined that doing so would be in the interest of consumers and in the public interest.

The CFPB had proposed to waive this ban so that creditors could charge upfront points and fees in connection with a mortgage loan, but only so long as the creditors made available to consumers an alternative loan that did not include upfront points and fees. It would appear that this matter is still unsettled, because the CFPB has decided not to finalize that proposal at this time since, it claims, it has "concerns" that it would create "consumer confusion" and "other negative outcomes."

Consequently, at this time, the CFPB is issuing a complete exemption to the prohibition on upfront points and fees, pursuant to its own exemption authority under section 1403, while it scrutinizes several crucial issues relating to "the proposal's design, operation, and possible effects in a mortgage market undergoing regulatory overhaul." To derive this information, the CFPB plans consumer testing and other research to understand consumers' understanding of and choices with respect to points and fees.

Loan originator qualification and identifier requirements.

Dodd-Frank imposed a duty on individual loan officers, mortgage brokers, and creditors to be "qualified" and, when applicable, registered or licensed to the extent required under State and Federal law. The Final Rule imposes duties on loan originator organizations to make sure that their individual loan originators are licensed or registered as applicable under the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) and other applicable law.

For financial institutions whose employees are required to be registered - such as depository

institutions and *bona fide* non-profits - the Final Rule requires them to (1) ensure that their loan originator employees meet character, fitness, and criminal background standards similar to existing SAFE Act licensing standards, and (2) provide training to their loan originator employees that is appropriate and consistent with those employees' origination activities.

Also specifically required in the Final Rule are special provisions that require criminal background checks and the circumstances in which a criminal conviction is disqualifying and, furthermore, even describes situations in which a credit check on a loan originator is required.

With regard to loan originators, the Final Rule implements a requirement that they provide their unique identifiers under the Nationwide Mortgage Licensing System and Registry (NMLSR) on certain loan documents. Accordingly, mortgage brokers, creditors, and individual loan originator employees that are primarily responsible for a particular origination will be required to list on enumerated loan documents their NMLSR unique identifiers (NMLSR IDs), if any, along with their names.

Prohibition on mandatory arbitration clauses and single premium credit insurance.

There is language implementing two other Dodd-Frank provisions concerning mortgage loan originations.

The first prohibits the inclusion of clauses requiring the consumer to submit disputes concerning a residential mortgage loan or home equity line of credit to binding arbitration. It also prohibits the application or interpretation of provisions of such loans or related agreements so as to bar a consumer from bringing a claim in court in connection with any alleged violation of Federal law.

The second provision prohibits the financing of any premiums or fees for credit insurance (i.e., credit life insurance) in connection with a consumer credit transaction secured by a dwelling, but it does permit credit insurance to be paid for on a monthly basis.

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