Enhancing HOEPA:
The CFPB's Changes to Regulations Z & X

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Webinar Agenda

The Webinar focuses on the CFBP's Final Rule implementing changes to the Homeownership and Protection Equity Act. The Webinar consists of two main sections:

1. Determining when a loan is a high-cost mortgage and what restrictions and protections come with that determination; and
2. How the HOEPA Final Rule affects non high-cost mortgages.

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General HOEPA Review

- Historically, HOEPA was enacted to address abusive practices in refinances and closed-end home equity loans with high interest rates or high fees. These transactions are often called “HOEPA loans” or “Section 32” loans.
- The 2010 Dodd-Frank Act expanded HOEPA coverage by including purchase-money mortgages as well as open-end credit plans such as HELOCs.
- The CFPB’s new HOEPA Rule implements these changes coming out of Dodd-Frank and has an effective date of January 10, 2014.
- The Final Rule also implements new counseling requirements that apply to creditors regardless of whether the loan is high-cost or not.

Determining if a Loan is a High-Cost Mortgage

- Generally 4 types of transactions are subject to HOEPA coverage:
  - Purchase-money mortgages
  - Refinances
  - Closed-end home equity loans
  - Open-end credit plans
- The Final Rule does exclude certain types of transactions from the HOEPA high-cost coverage, including:
  - Reverse mortgages
  - Construction loans
  - Loans originated and directly financed by a HFA
  - Loans originated under the USDA’s Rural Development Direct Loan Program

High-Cost Mortgage Test

There are three types of HOEPA coverage tests:

<u>APR Coverage Test:</u>

- A transaction is a high-cost mortgage if the APR exceeds the APOR by more than:
  - 6.5% for first lien mortgages;
  - 8.5% for first lien transactions that are for less than $50,000 and secured by personal property;
  - 8.5% for junior-lien transactions.
- To calculate the APR under the Final Rule:
  - Use the interest rate in effect on the date you set the rate for fixed rate transactions;
  - For transactions with variable rates with an index, you use the greater of the introductory interest rate or the fully indexed rate;
  - For transactions with variable rates not based upon an index, use the maximum rate the applicant can pay during the life of the loan.

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High-Cost Mortgage Test, Continued

APR Coverage Test, Continued:

- If the APR is more than 6.5 or 8.5 percentage points higher than the APOR, the loan is high-cost.
- For HELOCs, the lender is to compare the HELOC's APR to the APOR for the most closely-comparable closed end transaction.

Points and Fees Coverage Test

- The transactions total points and fees cannot exceed:
    - 5% of the total loan amount for a loan greater than or equal to $20,000; or
    - 8% of the total loan amount or $1,000 for a loan amount less than $20,000

High-Cost Mortgage Test, Continued

Points and Fees Coverage Test, Continued:

- The points-and-fees test is the same general approach used in the new QM regulation.
- For HELOCs, you use the same overall approach as for fixed transactions and add (i) participation fees payable at or before account opening; and (ii) fees charged to draw on their HELOCs.

Prepayment Penalty Coverage Test:

- A loan will be considered high-cost if a prepayment penalty is charged (i) more than 36 months after consummation or account opening; or (ii) an amount more than 2% of the amount prepaid.

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High-Cost Mortgage Test, Continued

Prepayment Penalty Coverage Test, Continued

- The Final Rule defines Prepayment Penalty as follows:
  - For closed-end transactions, prepayment penalty is a charge imposed for paying off all or part of the loan's principal balance before the due date.
  - For HELOCs, a prepayment penalty is a charge imposed if the consumer terminates the HELOC prior to the end of the terms.

HOEPA Restrictions & Protections

The HOEPA Final Rule provides various consumer protections, including:

1. Heightened disclosure requirements;
2. Restrictions on transaction terms;
3. Restrictions on fees and practices;
4. Ability-to-repay requirements;
5. A pre-loan counseling requirement.

HOEPA Restrictions & Protections, Continued

Disclosure Requirements:

- The requirement that the borrower is provided with a disclosure a minimum of 3 days prior to closing is retained. The disclosure must:
  - State the loan is not effective until consummation or account opening;
  - Explain the consequences of default;
  - Disclose loan terms such as APR, amount borrowed, and monthly payment;
  - For variable rate transactions, you must explain the maximum required monthly payment.
- The disclosure contains specific wording that must be included which can be found in appendix H to Regulation Z.

HOEPA Restrictions & Protections, Continued

Loan Term Restrictions:

- Balloon payments are only allowed in high-cost mortgages in the following circumstances:
  - Payment schedule is adjusted to accommodate the borrower's seasonal or irregular income;
  - Loan is a short-term bridge loan to finance a new home purchase for a borrower selling an existing home;
  - Creditor meets criteria for serving a predominantly rural or underserved area, and the loan meets specific criteria set forth in the ATR/QM Rule.
- Due-on-Demand Features are allowed only when:
  - Consumer commits fraud or makes a material misrepresentation in connection with the loan agreement;
  - The consumer defaults;
  - The consumer's action or inaction adversely affects your security interest

HOEPA Restrictions & Protections, Continued

Other Protections:

- Lenders and brokers are prohibited from recommending default on an existing loan to be refinanced by a high-cost mortgage;
- Cannot charge a fee to modify, defer, renew, extend, or amend a high-cost mortgage;
- Late fees are restricted to 4 percent of the past due payments and you cannot pyramid late fees;
- Generally payoff statement fees are prohibited;
- A loan cannot be purposefully structured to evade HOEPA coverage.

HOEPA Changes

The Final Rule leaves the following restrictions and prohibitions on high-cost mortgages in place:

- Prohibition on Negative Amortization features;
- Payment schedule consolidations;
- Prohibition on increase in interest rate after default;
- When acceleration has happened as a result of a default, a refund of interest must be calculated in a manner at least as favorable to the consumer as the actuarial method;
- Cannot pay a contractor under a home-improvement contract out of the proceeds from a high-cost mortgage;
- Cannot sell a high-cost mortgage on the secondary market without providing the appropriate disclosures to the assignee;
- Cannot refinance a high-cost mortgage into another high-cost loan within a year of the initial financing.

HOEPA Ability-to-Repay

- While historically lenders had to determine the borrower's ability to repay when originating a high-cost mortgage, the Final Rule requires lenders to satisfy the same ability to repay requirements as other closed-end mortgages under ATR.
- As ATR/QM does not apply to HELOCs, the HOEPA Final Rule lists specific ability to repay requirements the lender must consider, including:
  - Current and reasonably expected income or assets;
  - Current obligations, including any mortgage-related obligations such as property taxes, HOA fees, rent, and required insurance premiums.
- HOEPA Section 34(a)(iii) does provide a lender with a presumption of compliance if it meets the specific criteria, similar to QM with ATR.

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HOEPA Homeownership Counseling

High-Cost Mortgages:

- A borrower must receive homeownership counseling from a HUD approved counsel or state housing finance authority prior to consummating a high-cost loan. The lender must have written certification of this counseling.
- The borrower must receive the GFE or HELOC disclosures prior to taking the counseling session.
- Due to the various certifications the counselor must provide, it is easiest to separate the counseling into two sessions:
  - Session 1 – consumer will receive counseling on the mortgage after receiving the initial disclosures;
  - Session 2 – the counselor confirms receipt of all the additional required disclosures prior to issuing certification.

HOEPA Homeownership Counseling, Continued

<u>High-Cost Mortgages, Continued:</u>

- The counselor cannot be affiliated with the lender/creditor and the lender cannot steer the consumer to particular counselors;
- A creditor *can* pay for the counseling for the borrower, however payment for the counseling cannot be predicated on the borrower getting the high-cost loan. The fee can also be financed as part of the transaction.

Homeownership Counseling, Continued

<u>Non High-Cost Mortgages:</u>

- The HOEPA Final Rule implements two Dodd-Frank provisions applicable to all lenders regardless of whether they originate high-cost loans:
  - Requirement for pre-loan counseling for negative-amortization loans made to first-time homebuyers;
  - Requirement to provide federally-related loan applicants a list of housing counselors.

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Homeownership Counseling, Continued

Non High-Cost Mortgages, Continued:

- Negative-amortization counseling:
  - Similar to the high-cost counseling requirement, a creditor must obtain sufficient documentation showing the first-time borrower received the counseling prior to consummation of the loan.
- List of homeownership counseling organizations:
  - Creditors must provide applicants for federally-related mortgages a written list of homeownership counseling organizations within three business days of receiving their application.

Final Thoughts

- Overall, many of the existing HOEPA requirements have been retained and the 2013 HOEPA Final Rule has added additional requirements or restrictions.
- The Final Rule is closely related to other rules and regulations, especially the Ability-to-Repay and Qualified Mortgage standards. This emphasizes the need to fully understand each of the regulations taking effect in January. It is not advisable to focus solely on one regulation without the 'bigger picture' in mind on how they are interrelated.
- While the majority of the HOEPA requirements are focused on high-cost mortgages, the RESPA changes under the HOEPA rule apply to non-high cost mortgages as well.
- As always, it is critical to ensure systems are updated and any automatic calculations being performed are functioning properly prior to the implementation date.