BUCKLEYSANDLER LLP

"DODD-FRANK"
What it Means for Your Mortgage Business

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Overview

- **Bureau of Consumer Financial Protection**
  - **What Powers and Responsibilities Does It Have?**
  - **Who Does It Regulate?**
  - **What laws does it interpret and enforce?**

The BCFP– Structure

- Functional 6-12 months after enactment (designated transfer date to be published by Treasury Secretary)
- Headed By Director – 5 year term
- Housed in Fed, but considered an Executive Agency
- Will receive consumer protection staff from banking agencies, NCUA, HUD, (maybe) FTC
- Mandatory Offices / Functional Units
  - Research
  - Fair Lending and Equal Opportunity
  - Community affairs (assistance to underserved)
  - Consumer complaints
  - Financial education
  - Armed forces and senior protection
- Consumer Advisory Board
- Civil Penalty Fund
  - For payments to victims of violations

The BCFP – Basics

- Generally, the BCFP is tasked with regulating and enforcing the "enumerated" consumer protection laws
  - AMT Parity Act, Consumer Leasing Act
  - Electronic Funds Transfer Act, Fair Credit Billing Act
  - Fair Credit Reporting Act, FDCPA,
  - Gramm-Leach-Bliley (privacy) Act (w/ exceptions)
  - RESPA, TILA, HOEPA, SAFE Act
  - Truth in Savings Act, Interstate Land Sales Full Disclosure Act
  - Title XIV Mortgage Reforms (amend TILA)
  - ***Not***: Fair Housing Act, FTC Act
- BCFP has exclusive rulemaking authority over these laws
- But existing orders, rulings, determinations, agreements continue in effect and enforceable by transferor agency
  - Exception: BCPF will enforce existing rulings, etc. for large banks

The BCFP – Who Is Covered?

- "Covered persons," "related persons" and "service providers" providing "consumer financial products or services."
  - "Covered Persons" - those who engage directly or indirectly in offering a consumer financial product or service or an affiliate, if a service provider.
  - "Related Persons" – directors; officers; employees; stockholders, JV partners, consultants and others who "materially participate" in the subject business; independent contractors, including attorneys, appraisers, or accountants, who knowingly or recklessly violate a consumer law or regulation or breach of duty.
  - "Service Providers" - any person who provides a material service to a covered person in the provision of a consumer financial product or service – an activity that includes designing, operating, or maintaining the product or service or processing transactions related to the product or service.
    - Not general, ministerial worker of type provided to businesses generally

BCFP – Consumer Financial Products / Services

- Engaging in these activities makes you a covered person
  - Extending credit / servicing loans, including acquiring, purchasing, selling, brokering, or servicing loans or other extensions of credit (not warehouse lending);
  - Debt collecting related to any consumer financial product or service;
  - Providing real estate settlement services; appraisals
  - Providing financial advisory services (not subject to SEC)
  - Deposit-taking activities, payment processing, credit reporting, stored value card issuance, credit counseling, debt management
  - Other activities BCFP decides impacts consumers if BHC permissible activity
- Excluded from the list:
  - Business of insurance
  - Electronic conduit services

The BCFP – Specific Exemptions

- Merchants, retailers, or sellers of nonfinancial goods or services,
- Licensed real estate brokers / agents (except if providing a CFPS)
- Accountants, tax preparers, attorneys
- Auto dealers
- Persons regulated by:
  - SEC
  - CFTC
  - any state securities or insurance regulator (except when providing a CFPS).
- Qualified retirement or eligible deferred compensation plans and arrangements,

The BCFP – Rulemaking Authority

- General Powers
  - Promulgate rules to enforce enumerated consumer protection laws
  - Exempt any class of covered persons, service providers or consumer financial products or services
- Limits and Checks
  - BCFP must
    - Consider the costs and benefits to all consumers and covered persons;
    - Consult with the appropriate agencies regarding the rule's consistency with the prudential, market, or systemic objectives of those agencies;
    - Include and respond to any agency objections to proposed rules in the final rulemaking.
  - Financial Services Oversight Council objection process if financial system stability or safety and soundness at risk
- Deference in court – BCFP treated as only agency w/ power to interpret and enforce enumerated consumer protection laws

The BCFP – Non-depository institutions

- Exclusive authority to require reports and conduct compliance exams of non-depository institutions for Federal consumer financial law (enumerated laws plus UDAP), which include:
  - Covered persons offering, providing, originating, brokering, or servicing loans secured by real estate, loan modifications or foreclosure relief services
  - Other large non-bank covered persons, as defined by rule
  - Payday lenders
  - Covered persons whom the BCFP has reasonable cause to determine that the covered person is engaging in conduct that poses risks to consumers
  - Persons who offer or provide private education loans.
- Risk-based supervision (consider extent of state oversight)
- Rules include "ability to honor obligations"
- States continue oversight authority over state laws

The BCFP – Depository Supervision

- Assets of over $10 billion (and such bank's affiliates)
  - Exclusive authority to require reports and conduct compliance exams
  - BCFP must coordinate exams with prudential regulator
  - Appeals process for conflicting examination findings
  - Primary authority to enforce Federal consumer financial laws
- Assets of $10 billion or less
  - May require reports, but prudential regulator retains exclusive authority to enforce compliance with Fed'l consumer financial laws
  - BCFP may include its examiners on a "sampling basis" on exams performed by the prudential regulator
  - BCFP must notify prudential regulator of material violations and recommend appropriate action

The BCFP – Additional Specific Powers

- Define and enforce unfair, deceptive, or abusive acts or practices
  - Unfair – substantial injury not outweighed by benefits to consumers, competition
  - Abusive – materially interfere with consumer understanding, OR takes unreasonable advantage of (i) lack of understanding or inability to protect interest of selecting appropriate product or (ii) reasonable reliance on covered person to act in consumer's interest

- Regulate consumer disclosures, including costs, benefits, and risks of any consumer financial product or service
  - Safe harbor if follow model forms
- Implement a combined TILA/RESPA disclosure within one year
- Consumers get access to their transaction file (unless confidential)
- Covered person must respond timely to BCFP concerning consumer complaints and comply with consumer's request for info

Preemption – New Standard

- State law preempted if:
  - Application would have a discriminatory effect on national banks in comparison with its effect on a state-chartered bank
  - Prevents, significantly interferes with, or materially impairs the ability of a national bank to engage in the business of banking – a codification of the *Barnett Bank v. Nelson* standard; or
  - Preempted by an enumerated federal consumer law other than this title.
- *Barnett Bank*
  - Federal law said banks located and doing business in any place with a population of not more than 5,000 people may, pursuant to OCC rules, act as an agent for an insurance company
  - Florida law prohibited affiliated banks from selling insurance
  - Held that the state's prohibition of insurance activities "stands as an obstacle to the accomplishment" of the Federal Statute's purpose – that banks in certain situations could act as agent of insurance companies.
    - "Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted"

Preemption – Additional Changes

- *Wachovia v. Watters* Repealed – preemption does not extend to operating subsidiaries of national banks and thrifts

- *Cuomo v. Clearing House Ass'n*. Codified - nothing intended to limit or restrict "the authority of any attorney general (or other chief law enforcement officer) of any State to bring an action against a national bank in a court of appropriate jurisdiction to enforce an applicable law and to seek relief as authorized by such law.

    - State AG may bring a civil action against national bank or federal thrift in that state, where the state has jurisdiction over the defendant, to enforce a regulation issued by BCFP under Title X and to secure remedies under Title X or remedies otherwise provided under other law.

- Limited deference for OCC preemption determinations

- Interest rate exportation is not affected

- Majority of states may petition to have BCFP regulation modified

Mortgage Reforms

Mortgage Reform – Effective When?

- In General
  - Final regulations issued w/in18 mos. after “designated transfer date”, which is betw. 6-12 mos. after enactment
  - Regs to take effect w/in 12 mos. after final rule issued
  - If BCFP fails to issue rules within 18 months, statutory language takes effect
  - Compliance required = (6 to 12) + 18 + 12 = 36 to 42 months
- For provision where no regulations are required?
  - “A section of this title for which regulations have not been issued on the date that is 18 months after the designated transfer date shall take effect on that date.”

Mortgage Reform – Mortgage Originators

- Key Elements
  - "Mortgage Originator" defined – includes "assist a consumer in obtaining a loan" – advising on terms, preparing packages, collecting info on behalf of borrower
    - Does not include servicers, including those doing mods
  - Compensation Rules (NA to creditor unless table-funded)
    - MO comp can't vary based on loan terms (other than amount)
    - Can't get origination fees from both borrower and another
      - N/A to third party fees if paid to non-affiliate
  - Regs prohibiting:
    - Steering a borrower into loan where lacks ability to repay or has predatory characteristics
    - Putting a borrower from Qualified Mortgage (QM) to a Non-QM
    - Abusive or unfair lending that promotes disparities
    - Mischaracterizing credit history, values or discouraging shopping
  - Penalties – TILA/HOEPA damages up to treble "compensation or gain" to MO

Mortgage Reform – Underwriting Standards

- Ability to Repay
  - Prior to origination, lender must make reasonable and good faith determination at time of consummation
    - Take account PITI, including MI
    - Consider
      - Credit history
      - Current income – verified and documented (unless Agency exempts for certain streamlined refi's)
      - "expected income the consumer is reasonably assured of receiving"
      - DTI
    - Determine based on fully amortizing loan
    - Strict rules for U/W non-standard loans (IOs, hybrid ARMs, neg am) – treat as fixed, fully indexed rate w/ fully amortized paymt
- Borrower may assert violation of anti-steering or ability to repay provisions in foreclosure, regardless of time limit on civil actions.

Mortgage Reform – Qualified Mortgages

- Safe Harbor/Presumption – creditor/assignee may presume loan meets "ability to repay" requirement if it is a QM
- QM Definition
  - No Neg-Am or IO or (w/ exception) balloon payments
  - Verified and documented income and assets
  - U/W based on fully amortized pay schedule with PITI
  - If ARM, underwritten to max rate for 1st 5 years
  - DTI complies with BCFP regs
  - "Points and fees" (new definition) do not exceed 3%
    - Include 3rd party charges if paid MO, creditor, or affiliate
    - Exclude 2 bona fide discount points if undiscounted rate ≤ 1% over APOR, or 1 discount point if undiscounted rate ≤ 2% over APOR, but not both
  - 30 year loan term or less
  - HUD, VA, Ag, Rural Housing must define own QM
- Rural and underserved areas will have special rules

Mortgage Reform – Points and Fees

- Generally will now include
  - Finance charges, other than interest
  - All compensation paid directly or indirectly by a consumer or creditor to an MO from any source, including an MO that is also the creditor in a table-funded transaction
  - Credit insurance premiums paid at closing
  - Max prepayment penalties
    - Includes all prepay fees incurred if loan refinances loan held by same creditor or affiliate
  - On HELOCs, include min. add'l fees required to draw down total LOC
- For QM purposes, will NOT include:
  - Bona fide third party charges not retained by the MO, creditor, or an affiliate
  - Either but not both of the following:
    - Up to 2 bona fide discount points, but only if the interest rate from which discount applies does not exceed APOR by > 1%, or
    - Up to 1 bona fide discount point, if the interest rate from which discount applies does not exceed APOR by > 2%
- For High Cost Loan purposes, will include:
  - Upfront private mortgage insurance premiums that exceed premiums charged by FHA under existing policies

Mortgage Reform – Additional Requirements

- Prepayment restrictions
  - Not allowed for non-QMs
  - QM, for this purpose, excludes ARMs and higher priced loans
    - 1sts: APR is 1.5% over APOR if loan under FHLMC conventional limit, 2.5% over if above limit; 2nds: 3.5% over APOR
  - On QMs, prepay penalty allowed is 3-2-1
- Prohibition, for principal dwelling loans, on financing single premium credit insurance
- No arbitration
- New disclosures required
  - List of housing counselors with “Special Information Booklet”
  - Neg-am provisions (1st time homebuyer of non-QM have counseling)
  - Anti-deficiency law protection at closing
    - If app for refi would lose protection, special notice B4 any agreement for such refi is consummated
  - Partial payment policies (at closing or when acquire loan)
  - 6 month advance notice for resets
  - Expanded TILA disclosures: PITI, settlement services, MO fees, total life-of-loan interest paid as %age of principal
  - Periodic statements, for each billing cycle, of principal, rate, reset, PPP, late charge, contact #, counseling agency

Mortgage Reform – High Cost Mortgages

- A credit transaction is considered a "high cost mortgage" if
  - First mortgage on principal dwelling where the APR > APOR by 6.5% or, 8.5% for junior liens or (liens on personal prop < $50K)
  - Total points and fees "payable in connection with the transaction," other than third-party charges not retained by creditor or MO, or affiliate, exceed 5% of the total transaction if greater than $20K (8% if less than $20K); or
  - Prepayment penalties more than 36 months after closing OR the penalties, in aggregate, > 2% of the amount prepaid.
- **Prohibitions**:
  - Financing points and fees or PPP on same creditor (or affiliate) refi,
  - Offering balloon payments, recommending defaults,
  - Charging late fees of over 4%, or modification or deferral fees.
- Payoff statement fees (for 1st 4 requests), but reasonable fax/courier fee allowed (after advising of statements carrying no charges). Payoff balances due to borrower in 5 business days
- Creditor must obtain a certification from an approved housing counselor that the borrower received pre-loan counseling
- Cure provision available to make loan not a high cost loan

Mortgage Reform - Servicing

- Escrow
  - Required for 1st loans on principal dwelling (i) with APR > 1.5% over APOR for loan amounts = or < Freddie Mac conventional loan limit and (ii) with APR > 2.5% over APOR for loan amounts > that limit, and gov't insured loans (exceptions by regulation)
  - Must survive 5 years unless MI can be terminated
  - Remaining escrow balance returned to borrower within 20 business days or credited to account for new mortgage
  - Pay interest if required by applicable law
  - Disclosure of escrow requirement 3 business days before closing
  - Disclosure if escrow not established of risks
- Prohibited Servicing Activities
  - obtaining force-placed hazard insurance unless there is a reasonable basis to believe the borrower failed to comply with requirements to maintain property insurance – two notices required
  - Failing to refund premiums in 15 days if evidence of borrower's coverage
  - charging fees for responding to valid qualified written requests
  - failing to respond in a timely fashion to a borrower's request to correct errors relating to the allocation of payment, final payoff balance
  - failing to respond within 10 business days to a borrower request to provide contact information about the owner assignee of the loan

Mortgage Reform - QWR

- Response to Qualified Written Requests
  - Response time for a notice of receipt of inquiry reduced to 5 days
  - Time for making changes or advising of no change reduced to 30 days
    - May be extended up to 15 days if the servicer notifies the borrower of the extension and the reason for delay

Mortgage Reform - Appraisals

- New appraisal independence requirements prohibiting
  - coercing (or attempting to coerce) appraisers,
  - mischaracterizing the appraised value of a property,
  - seeking to influence an appraiser,
  - threatening to withhold payment for an appraisal,
  - appraisers from having conflicts of interest in the property or transaction.
- No more using broker price opinions as the primary valuation of a property.
- "Higher risk mortgages" subject to new appraisal requirements and disclosures,
  - Violation results in $2K penalty
  - Principal dwelling loan, other than QM, which, for 1sts: APR is 1.5% over APOR if loan under FHLMC conventional limit, 2.5% over if above limit; 2nds: 3.5% over APOR
  - APR with a slightly higher APR than the average prime offer rate (APOR).
- Interim regs due within 90 days of enactment
- Lenders to compensate fee appraisers "customary & reasonable fee"
  - Based on agency schedules, studies, *excluding assignments ordered by appraisal management companies*

Credit Risk Retention

Credit Risk Retention

- Banking agency and SEC rules within 270 days of enactment requiring securitizers to retain economic interest in a portion of credit risk
  - Residential mortgage asset rules by banking agencies, SEC, HUD, FHFA
  - There can be a total or partial exemption for securitizations of assets issued or guaranteed by the US or agency of US
    - Fannie Mae and Freddie Mac not agencies for this rule
- Credit risk retained
  - 5% unless certain underwriting standards met – set by rule
  - "Qualified Residential Mortgages" Exempt
    - NOT the same as QM in mortgage reforms
    - No broader than a QM
    - Defined by the agencies, who consider U/W and product features having lower historical risk of default
      - Documentation / verification of assets / income, DTI, LTV ratios
      - Effect of balloon payments, prepayment penalties, IOs, neg am
  - Risk must be allocated between originator and securitizer
- Residential mortgage risk retention rules become effective 1 year after the final rule is published

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