Mortgage Reform Under the Dodd-Frank Act

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Dodd-Frank Act Overview

- The most significant financial reform law (849 printed pages) since the Great-depression legislation
- 16 titles to address different factors contributing to the crisis
- Title XIV (Mortgage Reform and Anti-Predatory Lending Act) makes important changes to residential mortgage lending
- Consumer Financial Protection Bureau (CFPB) issued 8 implementing regulations in January 2013 for Title XIV's provisions, which become effective in January 2014

Mortgage Rules

- Ability to repay/Qualified Mortgage rule
- Qualified Residential Mortgage Rule
- Loan servicer rule (TILA & RESPA)
- Loan originator compensation rule
- Higher-priced mortgage escrow rule
- Combined RESPA/TILA disclosures proposal
- Higher-priced mortgage appraisal rule
- ECOA rule for appraisals
- HOEPA counseling rule

Ability-to-Repay/Qualified Mortgage Rule

- Proliferation of residential mortgage loans made with little or no underwriting played a significant role in the financial crisis and prompted Congress to impose ability-to-repay (ATR) requirement on residential mortgage lenders

"It was the Wild West [with WaMu]," said Steven M. Knobel. "If you were alive, they would give you a loan. Actually, I think if you were dead, they would still give you a loan."

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Qualified Mortgages (QMs) under the Dodd-Frank Act (DFA)

- Lenders have two compliance options: the general ATR standard or the QM standard, which provides certain legal protection

- General ATR standard requires creditor to consider and verify 8 eight underwriting factors:
  - Current or reasonably expected income or assets
  - Employment status
  - Monthly payment on this loan
  - Monthly payment on “simultaneous loans”
  - Monthly payment for “mortgage-related obligations”
  - Current debt obligations
  - Monthly DTI ratio, or residual income
  - Credit history

Qualified Mortgages (QMs) under the Dodd-Frank Act (DFA)

- For QM standard, 4 different types of QMs:
  - General QM
  - Temporary GSE/federal agency QM
  - Small creditor balloon QM
  - Small creditor QM
- Slide 5 lists the requirements for these QMs
- QMs provide legal presumption of compliance with ATR requirement, while general ATR standard does not
- Strength of legal protection for QMs depends on whether QM is prime or higher-priced

Source: CFPB

General Comparison of Ability-to-Repay Requirements with Qualified Mortgages

	ATR Standard	General QM Definition	Agency/GSE QM (Temporary)	Balloon-Payment QM	Small Creditor QM	Small Creditor Balloon-Payment QM (Temporary)
Loan feature limitations	No limitations	No negative amortization, interest-only, or balloon payments	No negative amortization, interest-only, or balloon payments	No negative amortization or interest-only payments	No negative amortization, interest-only, or balloon payments	No negative amortization or interest-only payments
Loan term limit	No limitations	30 years	30 years	No more than 30 years, no less than 5 years	30 years	No more than 30 years, no less than 5 years
Points & fees limit	No limitations	3%	3%	3%	3%	3%
Payment Underwriting	Greater of fully indexed or introductory rate	Max rate in first 5 years	As applicable, per GSE or agency requirements	Amortization schedule no more than 30 years	Max rate in first 5 years	Amortization schedule no more than 30 years
Mortgage-related obligations	Consider and verify	Included in underwriting monthly payment[2] and DTI[3]	As applicable, per GSE or agency requirements	Included in underwriting monthly payment[2] and DTI[3]	Included in underwriting monthly payment[2] and DTI[3]	Included in underwriting monthly payment[2] and DTI[3]
Income or assets	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Employment status	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement
Simultaneous loans	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	Included in underwriting DTI	Included in underwriting DTI	Included in underwriting DTI
Debt, alimony, child support	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
DTI or Residual Income	Consider and verify	DTI ≤ 43 percent	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Credit History	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement

2 "Included in underwriting monthly payment" means that the rule does not require the creditor to separately consider and verify this factor. However, a creditor must consider this factor when underwriting the consumer's monthly payment under the rule.

3 "Included in underwriting DTI" means that the rule does not require the creditor to separately consider and verify these factors. However, a creditor considers and verifies these factors when calculating the consumer's debt-to-income ratio.

General QM

- Substantially equal, amortizing regular payments
- No negative amortization, interest-only payment, or balloon payment
- Loan term cannot exceed 30 years
- Points and fees cannot exceed 3% of the loan amount
- Underwriting must consider mortgage-related obligations, be based on maximum rate in first five years, and consider and verify income or assets used in making ATR determination
- Back-end DTI cannot exceed 43%, using methodology of Appendix Q of Regulation Z

Small Creditor QM

- Only applies to "small creditors"
  - $2 billion or less in assets in preceding calendar year
  - Made 500 or fewer 1^{st} lien mortgages in previous calendar year, including affiliates
  - Holds them in portfolio for at least 3 years (with exceptions) and not be subject to forward commitments

- Has same requirements as general QM, except:
  - DTI **can** exceed 43%
  - Small creditor can charge higher rate for 1^{st}-lien mortgage loan (up to 350 basis points over APOR) and still receive safe harbor for compliance with ATR requirement
  - Does not have to follow Appendix Q for calculating DTI

Small Creditor Balloon QM

- Only applies to “small creditors”

- Same requirements as general QM, except:
  - DTI **can** exceed 43%
  - Small creditor can charge higher rate for 1st-lien mortgage loan (up to 350 basis points over APOR) and still receive safe harbor for compliance with ATR requirement
  - Balloon payment is permitted
  - Loan term must be between 5 and 30 years
  - Must have fixed-rate and monthly amortizing payments (except for final balloon payment)
  - Does not have to follow Appendix Q for calculating DTI

- CFPB originally required creditor to make at least 50% of its mortgages in “rural & underserved areas” but is temporarily waiving requirement until January 10, 2016 while researching the issue because industry said definition was too narrow

Temporary GSE and Agency QM

- Applies to loans *eligible* to be purchased, insured, or guaranteed by GSEs (while in receivership), FHA, VA, U.S. Dept. of Agriculture, or Rural Housing Service
- Lender must follow GSE/government agency underwriting requirements instead of general QM underwriting requirements
- 43% DTI requirement does *not* apply
- This temporary QM expires for GSEs when Fannie/Freddie receivership ends, or for agencies when they adopt their own QM rule, or January 10, 2021, whichever comes first
- Congress is currently considering legislation to end receivership for Fannie and Freddie

QM 3% Points and Fees Test

- Points and fees cannot exceed 3% of the total loan amount (amount financed minus certain financed costs included in points/fees) for a loan greater than or equal to $100,000

- For loans under $100,000, different limits apply:
  - $3,000 for loan ≥ $60,000 but < $100,000
  - 5% of total loan amount for loan ≥ $20,000 but <$60,000
  - $1,000 for a loan ≥ $12,500 but < $20,000
  - 8% of total loan amount for loan < $12,500

- These amounts will be adjusted for inflation

Prepayment Penalties

- Prepayment penalties are prohibited for non-QMs, for adjustable rate loans, and for higher-priced loans

- For loans on which prepayment penalties are permitted, limits apply:
  - 2% during 1st two years
  - 1% during third year after consummation
  - No penalties allowed after 3rd year

- If loans containing prepayment penalties are offered, creditor must also show borrower a loan without the penalty

Changes to TILA Civil Liability under the Dodd-Frank Act

- Higher damages for violating ability-to-repay (ATR) or loan originator compensation (LOC) requirements: actual damages, twice the amount of the finance charge paid (capped at $4,000), the sum of all finance charges and fees consumer paid, court costs, and attorney’s fees — unless the creditor demonstrates that the failure to comply is not material.

- Statute of limitations extended from one year to three for ATR and LOC violations

- Setoff claims allowed for ATR or LOC violations in foreclosure without regard to statute of limitations

QMs and Fair Lending Risk

- Creditors have expressed concern that if they only offer QMs, fewer protected-class borrowers may qualify and they may be cited for disparate impact violation

- Mortgage data indicate that most current mortgages meet QM requirements; however, some targeted loan programs could be affected

- Richard Cordray recently observed: “If you're doing solid, responsible lending and you’re mindful of the fact that there are fair-lending concerns around it, I don't know that you need to change what you've been doing”

- Pending U.S. Supreme Court case in *Mount Holly v. Mt. Holly Gardens Citizens in Action, Inc.,* may also affect disparate impact issue. Decision expected in 2013-14 court term

QRMs under the Dodd-Frank Act

- Risk-retention rule requires residential mortgage securitizers to retain 5% of mortgages in portfolio– unless they originate QRMs
- Original proposal issued in 2011 and revised proposal issued August 2013 with comments due October 30, 2013
- Proposing QRM = QM for purposes of statutory exception from risk retention requirement
- Seeking comment on alternative “QRM Plus” approach
  - QMs + 1-4 Family Principal Dwelling + First Lien + Credit History Restrictions + LTV not exceeding 70%
  - Excludes QMs for GSE/federally guaranteed, small creditor and small creditor balloon loans
- Fewer loans would be exempt from risk retention requirements under this approach

Mortgage Servicing Rule: 9 Protections

- **Monthly mortgage statements**
  Servicers must provide clear billing statements (showing next payment due, how past payments have been applied, and other important loan information)

- **Warnings before interest rate adjustments**
  For mortgages subject to rate adjustments, servicers must provide notice 6 to 7 months before first rate adjustment

- **Force-placed insurance**
  Servicers can only force place insurance on property when they have a reasonable basis to believe insurance lapsed and have provided two notices to borrower

CFPB Mortgage Servicing: 9 Protections

- **<u>Early outreach for delinquent borrowers</u>**
  Servicers must contact borrowers who are at least 30 days late on their payments with options for avoiding foreclosure.

- **<u>Prompt crediting of payments</u>**
  Payments must be applied as of the day they are received, and the handling of partial payments is clarified.

- **<u>Accurate information management</u>**
  Servicers must have reasonable policies to ensure that when borrowers provide documents and information the servicers can find and use them.

CFPB Mortgage Servicing: 9 Protections

- **Direct and ongoing access to servicer personnel**
  Servicers must provide easy access to staff that could help borrowers who are late on their payments find options to avoid foreclosure.

- **Error resolution and information requests**
  Servicers must address borrower concerns about possible errors within certain timeframes and provide the information they request (5 business days to acknowledge and 30 business days to respond, and optional 15-day extension)

- **Evaluation for alternatives to foreclosure**
  Servicers that offer loan modifications must review applications quickly and notify the consumers about their options. Foreclosure sales would have to be delayed while a timely, completed application is pending.

Model Form for Rate Change

Changes to Your Mortgage Interest Rate and Payments on September 1, 2012

Under the terms of your Adjustable Rate Mortgage (ARM), you had a three-year period during which your interest rate stayed the same. That period ends on September 1, 2012, so on that date your interest rate and mortgage payment change. After that, your interest rate may change annually for the rest of your loan term.

	Current Rate and Monthly Payment	**New** Rate and Monthly Payment
Interest Rate	4.25%	6.25%
Total Monthly Payment	**$983.88**	**$1,211.81 (due October 1, 2012)**

Interest Rate: We calculated your interest rate by taking a published "index rate" and adding a certain number of percentage points, called the "margin." Under your loan agreement, your index rate is the 1-year LIBOR and your margin is 2.25%. The LIBOR index is published daily in the Wall Street Journal.

Rate Limits: Your rate cannot go higher than 11.625% over the life of the loan. Your rate can change each year by no more than 2.00%.

New Interest Rate and Monthly Payment: The table above shows your new interest rate and new monthly payment. Your new payment is based on the LIBOR index, your margin of 2.25%, your loan balance of $189,440 and your remaining loan term of 324 months.

Prepayment Penalty: Keep in mind that if you pay off your loan, refinance or sell your home before September 1, 2012, you could be charged a penalty of up to $3,400.00.

CFPB's Proposed RESPA/TILA disclosure form

- Congress directed the CFPB to integrate the disclosure required under the Truth in Lending Act and the Real Estate Settlement Procedures Act into one form
- CFPB conducted extensive consumer testing for the forms and issued a proposal
- A final rule is expected in the near future

CFPB's Proposed RESPA/TILA disclosure form

FICUS BANK
4321 Random Boulevard • Somecity, ST 12340

Save this Loan Estimate to compare with your Closing Disclosure.

Loan Estimate

DATE ISSUED 7/23/2012
APPLICANTS John A. and Mary B.
123 Anywhere Street
Anytown, ST 12345
PROPERTY 456 Somewhere Avenue
Anytown, ST 12345
SALE PRICE $180,000

LOAN TERM 30 years
PURPOSE Purchase
PRODUCT Fixed Rate
LOAN TYPE ☒ Conventional ☐ FHA ☐ VA ☐ ___________
LOAN ID # 123456789
RATE LOCK ☐ NO ☒ YES, until 9/21/12 at 5:00 p.m. EDT
*Before closing, your interest rate, points, and lender credits can change unless you lock the interest rate. All other estimated closing costs expire on **8/6/12** at 5:00 p.m. EDT*

Loan Terms		**Can this amount increase after closing?**
Loan Amount	$162,000	**NO**
Interest Rate	3.875%	**NO**
Monthly Principal & Interest *See Projected Payments Below for Your Total Monthly Payment*	$761.78	**NO**
		Does the loan have these features?
Prepayment Penalty		**NO**
Balloon Payment		**NO**

Projected Payments

Payment Calculation	**Years 1-7**	**Years 8-30**
Principal & Interest	$761.78	$761.78
Mortgage Insurance	+ 82	+ —
Estimated Escrow *Amount Can Increase Over Time*	+ 206	+ 206
Estimated Total Monthly Payment	$1,050	$968

Estimated Taxes, Insurance & Assessments *Amount Can Increase Over Time*	$206 a month	**This estimate includes** ☒ Property Taxes ☒ Homeowner's Insurance ☐ Other: *See Section G on page 2 for escrowed property costs. You must pay for other property costs separately.*	**In escrow?** **YES** **YES**

Cash to Close

Estimated Cash to Close	$16,054	Includes $8,054 in Closing Costs ($5,672 in Loan Costs + $2,382 in Other Costs – $0 in Lender Credits). See details on page 2.

Visit **www.consumerfinance.gov/learnmore** for general information and tools.

CFPB's Prototype Combined RESPA/TILA disclosure form

Closing Cost Details

Loan Costs

A. Origination Charges	**$1,802**
.25 % of Loan Amount (Points)	$405
Application Fee	$300
Underwriting Fee	$1,097

B. Services You Cannot Shop For	**$672**
Appraisal Fee	$405
Credit Report Fee	$30
Flood Determination Fee	$20
Flood Monitoring Fee	$32
Tax Monitoring Fee	$75
Tax Status Research Fee	$110

C. Services You Can Shop For	**$3,198**
Pest Inspection Fee	$135
Survey Fee	$65
Title – Insurance Binder	$700
Title – Lender's Title Policy	$535
Title – Title Search	$1,261
Title – Settlement Agent Fee	$502

D. TOTAL LOAN COSTS (A + B + C)	**$5,672**

Other Costs

E. Taxes and Other Government Fees	**$85**
Recording Fees and Other Taxes	$85
Transfer Taxes	$0
F. Prepaids	**$867**
Homeowner's Insurance Premium (6 months)	$605
Mortgage Insurance Premium (0 months)	$0
Prepaid Interest ($17.44 per day for 15 days @ 3.875%)	$262
Property Taxes (0 months)	$0

G. Initial Escrow Payment at Closing		**$413**
Homeowner's Insurance	$100.83 per month for 2 mo.	$202
Mortgage Insurance	per month for mo.	
Property Taxes	$105.30 per month for 2 mo.	$211

H. Other	**$1,017**
Title – Owner's Title Policy (optional)	$1,017

I. TOTAL OTHER COSTS (E + F + G + H)	**$2,382**

J. TOTAL CLOSING COSTS	**$8,054**
D + I	$8,054
Lender Credits	$0

Calculating Cash to Close

Total Closing Costs (J)	$8,054
Closing Costs Financed (Included in Loan Amount)	$0
Down Payment/Funds from Borrower	$18,000
Deposit	– $10,000
Funds for Borrower	$0
Seller Credits	$0
Adjustments and Other Credits	$0
Estimated Cash to Close	$16,054

Additional Information About This Loan

LENDER	Ficus Bank	**MORTGAGE BROKER**
NMLS/LICENSE ID		**NMLS/LICENSE ID**
LOAN OFFICER	Joe Smith	**LOAN OFFICER**
NMLS ID	12345	**NMLS ID**
EMAIL	joesmith@ficusbank.com	**EMAIL**
PHONE	123-456-7890	**PHONE**

Comparisons

Use these measures to compare this loan with other loans.

In 5 Years	$56,582 $15,773	Total you will have paid in principal, interest, mortgage insurance, and loan costs. Principal you will have paid off.
Annual Percentage Rate (APR)	4.494%	Your costs over the loan term expressed as a rate. This is not your interest rate.
Total Interest Percentage (TIP)	69.447%	The total amount of interest that you will pay over the loan term as a percentage of your loan amount.

Other Considerations

Appraisal We may order an appraisal to determine the property's value and charge you for this appraisal. We will promptly give you a copy of any appraisal, even if your loan does not close. You can pay for an additional appraisal for your own use at your own cost.

Assumption If you sell or transfer this property to another person, we
- ☐ will allow, under certain conditions, this person to assume this loan on the original terms.
- ☒ will not allow this person to assume this loan on the original terms.

Homeowner's Insurance This loan requires homeowner's insurance on the property, which you may obtain from a company of your choice that we find acceptable.

Late Payment If your payment is more than 15 days late, we will charge a late fee of 5% of the monthly principal and interest payment.

Refinance Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.

Servicing We intend
- ☐ to service your loan. If so, you will make your payments to us.
- ☒ to transfer servicing of your loan.

Confirm Receipt

By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

Applicant Signature Date Co-Applicant Signature Date

Registration or Licensing of Mortgage Loan originators

- Loan originators cannot originate mortgage loans unless licensed (non-banks) or registered (banks) in SAFE Act national registry and must include unique originator identification number on all loans
- SAFE Act licensing/registration requirements include criminal check, credit report check, MLO test, continuing education, and database of state disciplinary actions that public can access without charge
- Originators with felony convictions in last 7 years, or convictions at *any* time for crimes involving fraud, dishonesty, breach of trust, or money laundering, cannot be licensed or registered

Loan Originator Compensation (LOC)

- Federal Reserve Board issued LOC rules effective April 2011, which will be replaced by Dodd-Frank Act requirements, which are similar but contain additional protections

- LOC <u>cannot</u> vary with loan terms and conditions (except percentage of loan amount)

- If consumer compensates loan originator, originator cannot receive compensation from creditor or anyone else

- CFPB's final rule clarifies many issues concerning LOC, such as whether originators can participate in profit sharing plans

Escrow Rule

- Rule extends the period for a mandatory escrow for higher-priced mortgage loans (HPML) from one year to five
- HPML: APR exceeds average prime offer rate (APOR) +150 basis points for 1st lien loans or APOR + 350 basis points for subordinate lien loans), loan is higher-priced
- Exemption for small creditors operating predominately in rural or underserved areas
- Small creditor
  - $2 billion or less in assets in preceding calendar year
  - Made 500 or fewer 1st lien mortgages in previous calendar year, including affiliates
  - Holds them in portfolio for at least 3 years (with exceptions) and not be subject to forward commitments

Resources

- CFPB Mortgage Rule Page: http://tinyurl.com/cfpb-MR
- CFPB Mortgage Implementation Page: http://tinyurl.com/reg-imp
- CFPB ATR/QM Compliance Guide: http://tinyurl.com/CFPB-ATRQM
- CFPB ATR/QM YouTube video: http://tinyurl.com/CFPB-QM-video
- Amended QRM Rulemaking Proposal (Aug. 28, 2013): http://tinyurl.com/qrm-amended

Questions?