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Changes in Mortgage Regulation in 2013*

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In 2011 and 2012 the Federal banking agencies proposed several regulations to the mortgage industry, none of which have been finalized, but which affect every aspect of the business. This article reviews the proposed changes to mortgage regulation and the timing of the final rules.[1]

A. Integration of TILA and RESPA Disclosures

This easily could be the biggest undertaking of the Consumer Financial Protection Bureau (CFPB) to date. The Dodd-Frank Act directs the CFPB to integrate the mortgage disclosures under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA). The CFPB engaged a research firm and performed qualitative testing for ten months, while also seeking public feedback by posting versions of the forms on the CFPB's website. The result was a nearly 1,100-page proposed rule issued in early July 2012, meeting the statutory deadline.

The proposal introduces two new forms: (1) an early disclosure (Loan Estimate) that is three pages and combines the early TILA disclosure and the Good Faith Estimate; and (2) a final disclosure (Closing Disclosure) that is five pages and combines the final TILA disclosure and the HUD-1. In addition to combining existing requirements, these forms include new disclosures required under Title XIV of Dodd-Frank.[2]

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[1] Many of the Dodd-Frank mortgage provisions are self-effectuating on January 21, 2013, unless a final rule is issued before then. Once a final rule is issued, it must be effective no more than one year later. All but the integration of TILA and RESPA disclosures and the risk retention/QRM rule fall under this provision. Also, keep in mind that January 21, 2013 is the Inauguration; therefore, we would likely see these rules final by Friday, January 18, 2013.

[2] The CFPB has delayed the effective date of these new disclosures so they will take effect with the rest of the TILA-RESPA rule rather than on January 21, 2013.

The CFPB also proposed a new definition of the finance charge for closed-end mortgages, which is similar to a Federal Reserve Board's (Board) 2009 proposal. A fee or charge is included in the finance charge if it is (1) payable directly or indirectly by the consumer, and (2) imposed directly or indirectly by the creditor as an incident to, or a condition of, the extension of credit.

After one deadline extension, all comments were due in early November 2012, and the CFPB received over 2,800 public comments. This does not need to be finalized before January 21, and the CFPB has made it clear that it will not be finalized for some time, due to the facts that staff will be focused on other rules and that the TILA-RESPA proposal is extremely complex and lengthy.

B. Ability to Repay/Qualified Mortgage (ATR/QM)

Many agree that this is the most crucial rule for CFPB. It will determine the characteristics of mortgages for years to come and who will be able to qualify for a loan. Under Dodd-Frank, no creditor may make a residential mortgage loan "unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan."[3] If the loan is a Qualified Mortgage, the creditor "may presume" that the ability to repay test has been met.[4]

In April 2011, the Board proposed the ATR/QM rule, which then transferred to the CFPB. There are two major issues in the proposal: (1) whether the QM definition should provide a complete safe harbor or only a rebuttable presumption on meeting the ability to repay test; and (2) the scope of the definition, with some arguing that the definition should be broad because creditors largely will not make non-QM loans, and others believing that a narrow QM definition will force lenders to make non-QM loans, thus ensuring there is a vibrant non-QM market. The Bureau received nearly 900 comment letters on the proposal.

In May, the CFPB re-opened the rule for comment on two aspects: (1) evaluating data to assess the impact of debt-to-income ratio and residual income on loan performance; and (2) litigation issues, including timing of

[3] Dodd-Frank Act, §1411.
[4] Dodd-Frank Act, §1412.

the filing of suits related to ability to repay and the quantity, costs and outcomes of such lawsuits. The Bureau received 160 comments on this.

The final ATR/QM rule is expected to be issued soon, as it is due January 21, 2013.

C. Risk Retention/Qualified Residential Mortgage (QRM)

In March 2011, the credit risk retention/QRM rule was proposed by the Department of Housing and Urban Development (HUD), the Board, the Federal Deposit Insurance Corporation (FDIC), the Federal Housing Finance Agency (FHFA), and the Office of the Comptroller of the Currency (OCC). The proposal implements §941 of the Dodd-Frank Act, which requires securitizers to retain a portion of the credit risk of certain assets backing securities — 5% for residential mortgages, with several options on the form of that risk. The proposal includes a feature not required under the statute — in addition to the 5% risk retained, a premium capture cash reserve account must be established and used to absorb first losses on the securitization.

While the GSEs remain in conservatorship, they are exempt from risk retention, as are mortgages that meet the definition of QRM. The proposed QRM definition includes criteria on term, points and fees, debt-to-income ratio, loan-to-value ratio, down payment, and the credit history of the borrower. Both Republicans and Democrats in Congress expressed concern that the down payment requirement of 20% was excessive.

There were nearly 400 comment letters submitted. Dodd-Frank requires that the definition of QRM can be no broader than the definition of QM; thus, a final risk retention/QRM rule will not be released until the ATR/QM rule is issued. Risk retention/QRM is not one of the rules that must be finalized by January 21, but, once finalized and published in the Federal Register, the rule must be effective for residential mortgages one year later.

D. Loan Originator Compensation

In August, the CFPB released its proposal on loan originator compensation. The proposal includes a provision that a creditor may not impose any points and fees unless it makes available a comparable, alternative loan with no points and fees, but that is not needed if the consumer is unlikely to qualify for the alternative loan. The CFPB is proposing this to make certain portions of §1403 of Dodd-Frank workable, although mandating the option has been controversial.

The proposal amends the rule finalized by the Board in 2010, providing much needed clarity on what is a proxy for purposes of compensation. The proposal implements new requirements on loan originator qualifications for depository institutions. Over 700 public comments were submitted, and the final rule must be issued by January 21, 2013.

E. Home Owner's Equity Protection Act (HOEPA)

Over the summer, the CFPB issued a proposal that implements Dodd-Frank changes to what is a high cost mortgage under HOEPA. The Dodd-Frank Act lowers the APR trigger and benchmark for HOEPA coverage, and in implementing that change, the CFPB proposed two alternatives: the first follows the statutory changes, and the second is substantially similar but it substitutes a transaction coverage rate (TCR) for the APR as the rate to be compared to APOR. The Bureau argues that the TCR would minimize the impact of a new all-in APR (proposed as part of the TILA-RESPA rule). The proposal implements the changes to the points and fees trigger and the new prepayment penalties trigger under HOEPA.

It also includes a requirement that, prior to extending a high-cost mortgage, a creditor must receive certification that the consumer has obtained counseling from a HUD-approved counselor. This proposal implements §1450 of the Dodd-Frank Act, which requires lenders to provide a list of homeownership counselors to potential borrowers for all mortgages (not just high-cost) within three business days of application. The CFPB plans to develop a website portal to make it easier for lenders to generate this list.

The CFPB received nearly 250 comments, and a final rule is due January 21, 2013.

F. Escrow

In February 2011, the Board proposed new disclosures and additional requirements for escrow accounts under TILA. That rulemaking transferred to the CFPB in July 2011, and the CFPB is working to finalize the rule. The proposal implements §§1461 and 1462 of Dodd-Frank, which mandates escrow accounts for certain mortgages and establishes disclosures relating to these mandatory escrow accounts, and disclosures for consumers who waive escrow accounts. The Board received nearly 70 comments, and the Bureau is expected to finalize it in early 2013.

G. Appraisals

Two separate rulemakings were issued concerning appraisals.

1. Joint Agency Proposal

The CFPB, FDIC, Board, FHFA, National Credit Union Administration, and OCC issued a joint proposal implementing §1471 of the Dodd-Frank Act. Under it, a creditor may only extend a higher-risk mortgage if (1) the creditor obtains a written appraisal performed by a certified or licensed appraisal through a physical property visit of the property's interior; (2) the applicant is given a statement with certain information regarding the appraisal; and (3) the creditor provides the consumer with a free copy of any written appraisals at least three business days before closing. The agencies received over 80 comment letters, and, it must be finalized by January 21.

2. CFPB Proposal

To implement §1474 of Dodd-Frank, which amends the Equal Credit Opportunity Act, the CFPB issued a proposal requiring a creditor to provide free copies of all appraisals or valuations developed in connection with an application for a loan to be secured by a first lien on a dwelling upon completion and no later than three days prior to closing. Creditors must notify consumers of the right to receive a copy of each appraisal or valuation at no additional cost. Comments on this were due in mid-October, and the

Bureau received nearly 70 comment letters and is scheduled to finalize the rule by January 21, 2013.

H. Mortgage Servicing

The CFPB issued two separate rulemakings simultaneously addressing mortgage servicing. The CFPB utilized the website Regulation Room.org, a pilot project with Cornell University, to provide a new way for interested parties to submit comments and questions about a proposed rule. The comments received were compiled and submitted to the CFPB as a formal comment on the proposals.

1. TILA/Reg Z

The Regulation Z mortgage servicing proposal has 3 main components. The first is periodic billing statements for all closed-end residential mortgage loans, other than reverse mortgages, with specifics on the timing, form and content of these statements, as well as sample forms.

Secondly, the CFPB proposed to require servicers to provide a consumer whose mortgage has an adjustable rate (not just hybrid ARMs, as mandated by Dodd-Frank) with a notice 60 to 120 days before the rate resets. There is also an additional earlier notice prior to the first rate adjustment.

Finally, servicers must promptly credit payments from borrowers, and payments that are less than the full amount due must be held in a suspense account. A servicer must send an accurate payoff balance to a consumer within seven business days of a written request.

The Bureau received over 160 comments and is expected to publish a final rule in January.

2. RESPA/Reg X

The RESPA/Reg X mortgage servicing proposal included several provisions, some of which were required under Dodd-Frank and others were issued under discretionary authority of CFPB.

The CFPB proposed separate but parallel procedures for error resolution and responding to requests for information. The proposal has a finite list of what is an error, but the CFPB asked for comment on whether there should be a catch-all category. Notice of an error or a request for information may be made orally or in writing, but a servicer may establish a number and address specifically for these requests. Generally, a servicer must correct an error or respond with the information requested within 30 days of receiving the request. There are some instances in which these procedures would not apply.

The proposal includes model disclosure notices that must be sent to a borrower before a servicer can charge for force-placed insurance, and the charges must be bona fide and reasonable. A servicer must have a reasonable basis to believe there is no hazard insurance in place before obtaining force-placed insurance.

For borrowers who are late in making a payment, a servicer must provide information about the foreclosure process, contact information for housing counselors, and, if applicable, loss mitigation options. The servicer also must assign personnel, either a single person or a team, to respond to the borrower's inquiries and assist the borrower with loss mitigation. The proposal outlines several functions of the dedicated personnel, and the personnel is assigned until the loan is no longer the servicer's or the borrower has made timely payments for 3 months.

Finally, the proposal includes what is a loss mitigation application, timelines for review of an application, an appeals process for denied loan modification applications, and certain provisions on a borrower's response to a loss mitigation option. The proposal prohibits a servicer from proceeding to foreclosure sale while a loss mitigation application or appeal is pending. There are certain instances in which the servicer need not follow these procedures.

The Bureau received nearly 150 comments and is expected to publish a final rule in January.

2013 will be a busy year for the mortgage industry, starting with the issuance of the final rules of these proposals. They will reshape the entire mortgage process from the beginning disclosures, what loans are available with certain terms, to securitizing, servicing and loss mitigation efforts.

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