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FINANCIAL REGULATORY REFORMS UPDATE

Title XIV — Mortgage Reform and Anti-Predatory Lending Act

- **Mortgage Loan Origination and Minimum Standards for Mortgages.** The Act imposes restrictions on residential mortgage loan origination, including limits on originator compensation, a prohibition on certain prepayment penalties and a requirement that a creditor make a reasonable and good faith determination, based on verified and documented financial information of the consumer, that the consumer has a reasonable ability to repay a residential mortgage loan.
- **Other Provisions.** The Act also expands the definition of a "high-cost mortgage" under TILA and imposes new requirements on high-cost mortgages and new disclosure, reporting and notice requirements for residential mortgage loans, as well as new requirements with respect to escrows and appraisal practices.
- **Effective Date of Amendments**. The regulations to implement the new requirements must be in final form within 18 months of the date designated for transfer of functions to the Consumer Protection Bureau in accordance with the Act and the related amendments will take effect on the date the final regulations take effect (which must be within one year of the date the regulations are issued in final form).

Residential Mortgage Loan Origination Standards

- *Compensation.* Intending to prohibit "yield-spread premiums," the Act prohibits a mortgage originator from receiving compensation that varies based on the terms of the residential mortgage loan (other than the principal amount). The Act also prohibits an originator from receiving any origination fee or charge from any person other than the consumer except where:
  - no compensation is received directly from the consumer; and
  - unless otherwise waived or exempted by the Federal Reserve Board, the consumer does not make an upfront payment of discount points, origination points or fees (other than bona fide third-party charges not retained by the mortgage originator or creditor or any affiliate of either).
- Under regulations to be adopted by the Federal Reserve Board, mortgage originators will be prohibited from steering a consumer to residential mortgage loans that a creditor is prohibited from making as described below under "—Minimum Standards for Mortgages—Ability to Repay" or that have predatory characteristics or effects.

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Minimum Standards for Mortgages

- *Ability to Repay*. The Federal Reserve Board must adopt regulations prohibiting a creditor from making residential mortgage loans (other than reverse mortgages and bridge loans) unless it reasonably and in good faith determines, based on verified and documented information of the consumer's financial resources (other than the equity in the property), that at the time the loan is consummated the consumer has a reasonable ability to repay the loan according to its terms, as well as all applicable taxes, insurance (including mortgage guarantee insurance) and assessments.
  - The creditor's determination must be made using a payment schedule that fully amortizes the residential mortgage loan over the term of the loan.
  - If the creditor knows, or has reason to know, that one or more residential mortgage loans secured by the same property will be made to the consumer, it must make the determination with respect to the combined amount owed.
  - A creditor of a residential mortgage loan, and any assignee of the loan subject to liability under TILA, is presumed to have met the ability to repay determination requirement if the loan is a "qualified mortgage." For this purpose, a "qualified mortgage" includes a residential mortgage loan that is fully amortizing, limits the terms of balloon loans and deferred principal payments, requires verification of financial resources, limits points and fees charged and complies with thresholds with respect to debt-to-income level.
  - The Act also includes standards for determining a consumer's ability to repay under "nonstandard loans" including variable rate, interest-only and negative amortization loans.
  - The Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture and the Rural Housing Service may exempt a refinancing of a loan made, guaranteed or insured by it under certain circumstances.
- *Foreclosure Defense*. Violations of the origination and repayment verification standards set forth in Title XIV can be asserted as a defense to foreclosure by recoupment or set-off without regard for the time limit on a private action for damages.
- *Additional Standards and Requirements*. The Act prohibits prepayment penalties on residential mortgage loans other than "qualified mortgages."
  - Qualified mortgages for this purpose exclude residential mortgage loans with an adjustable interest rate or with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction (as of the date the interest rate is set) by prescribed amounts.
  - Prepayment penalties are prohibited on qualified mortgages after year three of the loan and, prior to year three, a prepayment penalty on a qualified mortgage loan cannot exceed 3% of the outstanding balance of the loan in year one, 2% in year two and 1% in year three.
  - The Act requires creditors offering a consumer a residential mortgage loan with a prepayment penalty to offer the consumer the option of a residential mortgage loan without a prepayment penalty.
  - The Act also:
    - imposes limits on creditors financing (in connection with any residential mortgage loan) any credit life, credit disability, credit unemployment or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreements or contracts;
    - prohibits residential mortgage loans from containing mandatory arbitration provisions;

    - imposes disclosure requirements with respect to: a creditor's policies with respect to partial payments; negative amortization loans; residential mortgage loans subject to protection under any State anti-deficiency law; and other disclosure and periodic reporting requirements with respect to residential mortgage loans, and imposes notice requirements with respect to resets of hybrid adjustable rate mortgages;
    - increases the civil money penalties available in TILA litigation, including an increase from $500,000 to $1 million for the maximum civil money penalty in a class action; and
    - requires a study by the GAO to determine the effect of the amendments on availability and affordability of credit, and the effect of the credit risk retention provisions with respect to non-qualified mortgages on the capital reserves and funding of lenders.

Other Provisions

- The Act also:
  - expands the definition of a "high-cost mortgage" under TILA and imposes new requirements on high-cost mortgages, including with respect to origination practices and loan terms;
  - adds a provision to TILA regarding escrow accounts, imposing substantive requirements as well as new disclosure rules;
  - amends TILA to address appraisal practices, and amends the Equal Credit Opportunity Act to expand the requirement to provide copies of appraisals to loan applicants;
  - requires that payments be credited promptly, and that payoff statements be provided promptly; and
  - establishes the Office of Housing Counseling to provide homeownership and rental housing counseling.
- While the Act does not include any specific provisions with respect to ending the conservatorship of Fannie Mae and Freddie Mac, the Act does state Congress' sense that efforts to enhance credit and practices related to credit through regulation of residential mortgage credit terms would be incomplete without enactment of meaningful structural reforms of Fannie Mae and Freddie Mac.

Effective Date of Regulations and Amendments

- The regulations to implement the new requirements must be in final form within 18 months of the date designated for transfer of functions to the Consumer Protection Bureau in accordance with the Act and the related amendments will take effect on the date the final regulations take effect (which must be within one year of the date the regulations are issued in final form). If regulations are not issued in final form in accordance with the preceding sentence, the amendments will take effect 18 months after the designated transfer date.

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