Mortgage Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act Will Affect Mortgage Brokers, Lenders, Appraisers, Settlement Service Providers, and Others

Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act) adds disclosure and substantive rules relating to mortgage lending that will affect mortgage brokers, lenders, appraiser settlement services providers, and others participating in mortgage lending. The new Consumer Financial Protection Bureau (CFPB) will have implementing rulemaking authority in this area which will be effective on the "designated transfer date."[1] Furthermore, the provisions of Title XIV will themselves generally become effective within 12 months after the CFPB's designated transfer date.

The following advisory is a summary of the substantive provisions of Title XIV that will affect mortgage originators and other mortgage loan service providers.

General Scope of Provisions

The provisions of Title XIV apply to most originators making residential mortgage loans. The term "mortgage originator" is defined broadly to include more loan origination participants than traditionally were covered by the term originator.

- The Act generally defines a mortgage originator as a person who, for pay, performs, or represents to the public that he or she performs, any of the following activities:
  - Takes a residential mortgage loan application;
  - Assists a consumer in obtaining or applying to obtain a residential mortgage loan; or
  - Offers or negotiates terms of a residential mortgage loan.

A person who merely performs clerical tasks for a mortgage originator is not a mortgage originator. Typical mortgage originators include brokers and loan officers.

1 The Secretary of the Treasury, in consultation with certain agenices, must establish the "designated transfer date," which must be no earlier than 180 days nor later than 12 months from the date the Act is enacted, extendable to no later than 18 months after enactment.

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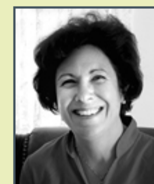

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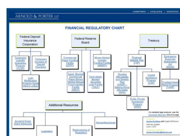

Financial Regulatory Chart

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- The Act defines a "residential mortgage loan" as a closed-end consumer loan secured by a mortgage (or other equivalent security interest) on a dwelling (or residential property that includes a dwelling). Importantly, the definition does not include home equity lines of credit (HELOC). But note that some of the requirements of the Act apply to both residential mortgage loans, as defined, and open-end loans (including HELOCs).

New Requirements for Mortgage Originators

Title XIV imposes the following new substantive requirements on mortgage originators:

- **Qualification.** The Act requires a mortgage originator to (a) be qualified and, when required, registered and licensed; and (b) include on all loan documents his or her unique identifier issued by the Nationwide Mortgage Licensing System and Registry.
- **Prohibition on Steering Incentives.** The Act prohibits a mortgage originator from receiving any compensation that varies based on the terms of a mortgage loan (other than the principal amount). The Act also requires anti-steering regulations to be promulgated in order to reduce the likelihood that a consumer would be steered toward loans with disadvantageous terms. The text states that those regulations are to be issued by the Board of Governors of the Federal Reserve System (Federal Reserve). However, because the Act specifically transfers responsibility for this title to the CFPB, it is possible that the regulations will be promulgated by the CFPB. The Act grants a consumer the right to assert a violation of these regulations as an affirmative defense in a foreclosure action without regard to the statute of limitations.
- **Limits on Compensation**. The Act would only allow a mortgage originator to be paid an origination fee by the consumer. This limitation would not apply if:
  - The mortgage originator does not receive any compensation directly from the consumer; and
  - The consumer does not make an upfront payment of discount points, origination points, or fees (except for exemptions that the Federal Reserve or more likely the CFPB may provide for by regulation).

  Yield spread premiums (YSPs) are prohibited if the total amount of direct and indirect compensation from all sources permitted to a mortgage originator would vary based on the terms of the loan (other than the principal amount).
- **Ban on Unfair and Deceptive Practices**. The Act gives the Federal Reserve (but presumably again this is the CFPB) the authority to promulgate regulations to ban acts or practices of mortgage originators that it finds to be unfair, deceptive, abusive, predatory, or necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers.

Minimum Standards for Mortgages

In addition to the imposition of new requirements on mortgage originators, Title XIV imposes new minimum standards for mortgage loans that are designed to discourage creditors from making some of the unconventional or hybrid loans that have been considered by many observers to have been a primary reason for the mortgage crises. These standards include the following:

- **Ability to Repay.** 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 and all applicable taxes and insurance over the loan term. If the property securing the proposed loan is subject to more than one lien (i.e., the property has both a first and a second lien on it), the creditor must make this determination with respect to all the loans secured by liens on that same dwelling. Violation of these rules are an assertable defense by a consumer in a foreclosure action without regard to the statute of limitations.
  - The creditor must consider credit history, current income, expected income, current obligations, debt-to-income ratio, employment status, and financial resources other than the house being mortgaged, among other underwriting criteria.
  - The creditor must verify income or assets, except with respect to refinancing of government guaranteed loans if:
    - The consumer is not 30 days or more past due on the existing loan;
    - The refinancing does not increase the principal

balance on the loan (except for fees and charges allowed by the federal agency);

- Total points and fees (other than *bona fide* third party charges not retained by the mortgage originator, creditor, or affiliate), do not exceed 3 percent of the total new loan amount;
- The interest rate on the refinance loan is lower than the interest rate of the originated loan (unless the refinancing involves converting an adjustable rate to a fixed rate);
- The refinancing is subject to a fully amortizing payment schedule;
- The terms of the refinance do not include a balloon payment; or
- Both the original loan and the refinance loan meet the requirements to be government guaranteed or insured.

There are several specific provisions relating to how a creditor must determine the borrower's ability to repay with respect to certain unconventional loans, including variable rate loans that defer repayment of any principal or interest, interest-only loans, and negative amortization loans. These rules would require the creditor to consider higher payments that the consumer would have to make but for the "unconventional" characteristics.

- **Safe Harbor Rules**. A creditor may presume that any residential mortgage loan it makes meets the "ability to repay" described above if the loan is a "qualified mortgage loan." To be a "qualified mortgage loan," it must possess the following parameters:

— It must not permit negative amortization or, subject to certain exceptions, deferred principal;

— Subject to certain exceptions, it must not require any balloon payment (defined as a scheduled payment that is more than twice as large as the average of earlier scheduled payments);

— The income and assets relied on to qualify the borrower must be verified and documented;

— Underwriting must be based on full amortization over the loan term;

— The debt-to-income ratio must not exceed certain guidelines to be set by regulation;

— Total points and fees must not exceed 3 percent of the total loan amount (with certain exceptions allowed for smaller loans in rural areas); and

— The loan term must not exceed 30 years, subject to certain exceptions.

Certain reverse mortgages and mortgages with balloon payments may be considered "qualified mortgages" under regulations to be promulgated that are to be consistent with these factors.

- **Refinance of Hybrid Loans with Current Lender**. The Act also sets forth factors to consider in determining a borrower's ability to repay when the creditor considers an application for refinancing of an existing hybrid loan made by the creditor into a standard loan. Under this provision, if there would be a reduction in monthly payment and the borrower has not been delinquent on any payment on the existing hybrid loan, the creditor, in determining the borrower's ability to repay, may: (i) consider the borrower's good standing on the existing mortgage; (ii) consider if the extension of new credit would prevent a likely default should the original mortgage reset and give such concerns a higher priority; and (iii) offer rate discounts and other favorable terms to such borrower that would be available to new customers with high credit ratings. It appears that the Act would allow the creditor to consider the borrower's ability to repay with a standard loan relative to the borrower's ability to repay under the existing hybrid loan, although the statutory language does not specifically say so.
- **Limits on Prepayment Penalties**. The Act also provides that no prepayment penalty may be allowed on a loan that is not a qualified mortgage loan. A prepayment penalty may be imposed on a qualified mortgage, but it would be subject to limits decreasing over a three year period from 3 percent of the loan balance to 1 percent of the loan balance. Moreover, a creditor may not offer a residential mortgage loan with a prepayment penalty without also offering one without a prepayment penalty.
- **Prohibition on Single Premium Credit Insurance**. No creditor may finance, with respect to any residential

mortgage loan or any HELOC secured by a consumer's principal dwelling, credit insurance paid as a lump sum, except for certain credit unemployment insurance sold by unaffiliated third parties.

- **Limitation on Arbitration**. No residential mortgage loan or open-end loan secured by a consumer's principal dwelling may include terms requiring arbitration or any other non-judicial procedure for resolving disputes. However, a consumer may agree to such a resolution method after a dispute arises.
- **Disclosures Regarding Negative Amortization**. Negative amortization loans secured by a dwelling, whether closed-end or open-end, would require additional disclosures regarding the impact of negative amortization.
- **Disclosures Regarding Anti-Deficiency Laws**. If a residential mortgage loan is protected by state anti-deficiency laws (i.e., state laws that provide that, in the event of foreclosure on the residential property of a consumer securing a mortgage loan, the consumer is not liable for any deficiency between the sale price obtained on such property through foreclosure and the outstanding loan balance), the creditor or mortgage originator must provide notice of such protection, and if a refinancing would cause the borrower to lose such protection, the creditor or mortgage originator in the refinancing must provide notice of such loss of protection.
- **Reset of Hybrid Adjustable Rate Mortgages**. Six months' notice is required for changing from a fixed rate to a floating rate on a hybrid adjustable rate mortgage. Similar notices also may be required by regulation for non-hybrid adjustable rate mortgages.
- **More Disclosure Requirements**. The Act also requires certain new disclosures to be provided at the closing of a mortgage loan and on periodic statements (or coupon books).
  - — New information that must be provided at the closing include:
    - Information regarding settlement charges, including the aggregate amount of such charges, and the amount included in the loan and that to be paid at the closing;
    - The approximate wholesale rate of funds in connection with the loan;
    - Mortgage originator compensation;
    - Total interest payments over the loan term as a percentage of the loan principal; and
    - Certain monthly payment information for variable rate loans with escrow accounts.
  - — New information that must be provided on periodic statements to be provided during each billing cycle include:
    - The amount of the loan principal;
    - The current interest rate;
    - The date on which the interest rate may reset or adjust;
    - Any prepayment fee;
    - Any late fee;
    - A phone number and an email address the borrower may use to obtain information on the loan;
    - Information on credit counseling agencies; and
    - Any other information required by regulation.
- **Lender Rights**. One provision in the Act favoring lenders is that if a borrower has been convicted of obtaining a residential mortgage loan by actual fraud, the lender may not be held liable for any violations of the Truth in Lending Act (TILA) with respect to that loan.

New Provisions Relating to High-Cost Mortgages

Title XIV also expands the applicability of the "high rates, high fees" provisions of TILA, added by the Home Ownership and Equity Protection Act (HOEPA). Currently, HOEPA and Section 32 of Regulation Z (which implements HOEPA) cover certain "high rates, high fees" loans, but generally, these current laws only apply to refinancing and home equity installment loans. The Act would make HOEPA apply to all "high-cost mortgages," including purchase money mortgages, and also add further consumer protections, as summarized further below.

- **Definition of High-Cost Mortgage Expanded**. Under the Act, a high-cost mortgage is redefined to be a loan (whether

closed-end or open-end) that is secured by the consumer's principal dwelling and that fits under any of the following:

- The annual percentage rate (APR) exceeds the average prime offer rate (i.e., a rate which will be published by the Federal Reserve, and then by the CFPB after the transfer of functions) for a comparable transaction by more than 6.5 percent if the loan is secured by a first mortgage, or by more than 8.5 percent if secured by a second mortgage;
- The total points and fees exceed (i) 5 percent of the loan amount if the loan is $20,000 or more; or (ii) the lesser of 8 percent of the loan amount or $1,000 if the loan amount if less than $20,000; or
- Prepayment penalties exceed more than 2 percent of the amount prepaid.

- **Restrictions on High-Cost Mortgages**. If a loan is considered a high-cost mortgage:
  - The loan cannot be subject to any balloon payment (i.e., a scheduled payment that is more than twice as large as the average of earlier scheduled payments).
  - Late fees are limited.
  - Acceleration of any high-cost mortgage is restricted.
  - Points and fees on a high-cost mortgage may not be financed.
  - Pre-loan counseling is required.

Creation of Office of Housing Counseling

Title XIV establishes the Office of Housing Counseling (Office) within the US Department of Housing and Urban Development (HUD). The Office will have primary responsibility within HUD for all activities and matters relating to homeownership counseling and rental housing counseling. Some of the provisions relating to the Office may impact mortgage originators. For example:

- The CFPB is directed to revise the Special Information Booklet required by Section 5 of The Real Estate Settlement Procedures Act (RESPA) (renamed Home Buying Information Booklet under the Act) to meet the new contents requirement of Title XIV. The Office is required to contribute to this revision. In addition to the information currently required, the updated booklet must include such information as:
  - Additional details on the nature and purpose of the costs incident to a real estate settlement on a federally related mortgage loan (which is defined in RESPA and covers most mortgage loans), including both general information about the mortgage process and specific information concerning balloon payments, prepayment penalties, the advantage of prepayment, and the trade-off between closing costs and the interest rate over the life of the loan;
  - An explanation of certain things a consumer should consider in shopping for a loan, including the ability to repay, and loan terms such as prepayment penalties and balloon payments;
  - An explanation of the right of rescission as to certain transactions;
  - An explanation of the nature of a variable rate mortgage, a HELOC, and real estate appraisal; and
  - Information about homeownership counseling services and the consumer's responsibilities, liabilities, and obligations.
- HUD is directed to take actions to inform potential homebuyers of the availability and importance of obtaining an independent home inspection, including the publication of certain booklets. Lenders approved by the Federal Housing Administration are required to provide such booklets to prospective homebuyers.

New Provisions Relating to Mortgage Servicing

Title XIV of the Act also imposes additional requirements relating to mortgage servicing, mostly relating to the establishment and maintenance of escrow accounts.

- **Mandatory Escrow Account**. A creditor is required to establish an escrow account for the payment of taxes, insurance premiums, and other required assessments with respect to a closed-end loan secured by a first lien on the principal dwelling of a consumer, if:
  - Federal or state law requires such an escrow account;
  - The loan is made, guaranteed, or insured by a state or federal governmental lending or insuring agency;
  - The APR on the loan exceeds the average prime

offer rate for a comparable transaction by at least 1.5 percentage points for a loan that does not exceed the applicable conforming loan limit, or by at least 2.5 percentage points for a loan exceeding the applicable conforming loan limit; or

— Any regulation requires such an escrow account.

The Act allows for the Federal Reserve (which again presumably will be the CFPB) to allow for exceptions from this requirement for creditors operating in rural and underserved areas that retain their loans in portfolio. In addition, new or modified requirements may be imposed if such modifications would be in the interests of consumers and in the public interest.

- If required, the escrow account generally must be maintained for at least five years from the loan closing, unless (i) the borrower has sufficient equity in the dwelling to no longer be required to maintain private mortgage insurance; (ii) the borrower becomes delinquent on the loan; (iii) the borrower otherwise has not complied with a legal obligations as established by rule; or (iv) the mortgage is terminated.
- The creditor must provide certain disclosures regarding the mandatory escrow account at least three business days before the closing (or as otherwise provided by regulation), including the amount required to be placed in escrow at closing, the amount required for the first year, and the estimated monthly payment into escrow.
- Where establishment of an escrow account is not mandatory, the creditor or servicer must give the borrower disclosures regarding the responsibilities of the borrower and the implications if an escrow account is not maintained.
- If an escrow account is established, the repayment schedule must take into account the monthly escrow payments.
- A servicer of a federally related mortgage may not obtain force-placed hazard insurance unless the borrower fails to comply with the insurance requirements after the servicer has sent two written notices to the borrower.
- Escrowed amounts must be refunded to the borrower within 20 business days of loan pay-off.
- The Act also requires that servicers generally credit a payment to the consumer's loan account as of the date of receipt, unless any delay in crediting does not result in any charge to the consumer or the reporting of negative information to a consumer reporting agency.
- A creditor or servicer of a home loan also must provide an accurate payoff balance within seven business days after receiving a written request.

Appraisal Activities

Finally, Title XIV contains new rules governing the appraisal of residential property securing mortgage loans.

- **Appraisal Required for Higher Risk Loans**. The Act prohibits creditors from making a "higher risk" (which is a wording change from "subprime") mortgage loan to any consumer without obtaining a written appraisal of the property to be mortgaged in accordance with the following requirements:

  — The appraisal is performed by a qualified appraiser who conducts a physical property visit of the interior of the property; and

  — A second appraisal is performed if the loan is to finance the purchase of the mortgaged property from a person who purchased the property at a price lower than the current sale price less than 180 days earlier.

  For this purpose, a qualified appraiser is defined as one that is licensed by the state and conforms with the applicable rules. A higher risk loan is defined as a residential mortgage loan secured by a principal dwelling with an APR that exceeds the average prime offer rate for a comparable transaction by at least 1.5 percentage points in the case of a first lien loan having an original principal amount not exceeding the applicable conforming loan limit, or by at least 2.5 percentage points for a first lien loan exceeding the applicable conforming loan limit, or by at least 3.5 percentage points for a subordinate lien loan.

- **Unfair and Deceptive Practices**. Certain practices compromising appraisal independence are considered unfair and deceptive under the Act, including:

  — A person with an interest in the credit transaction,

compensating or otherwise influencing the appraiser; and

- — Mischaracterizing or inducing any mischaracterization of the appraised value of the mortgaged property.

- **Conflict of Interests Prohibited**. The Act prohibits an appraiser from being involved in appraising the principal dwelling of a consumer offered as security for a consumer loan if the appraiser has an interest in the property or transaction.

- **Mandatory Reporting of Appraiser Violation**. If a person involved in a mortgage transaction, such as a mortgage broker, mortgage lender, or real estate broker, has a reasonable basis to believe that the appraiser failed to comply with applicable laws or standards, that person must report such failure to the applicable state licensing agency. The Act also prohibits a creditor from extending credit on the basis of an appraisal that fails to meet certain independence standards.

- **Regulation of Appraisal Management Companies**. The Act regulates appraisal management companies (i.e., companies that oversee more than 15 certified or licensed appraisers in a state or 25 or more nationally in a year), requiring them to be registered and supervised by a state appraiser certifying and licensing agency. A company that is a subsidiary of an insured depository institution will be regulated by the federal regulator for the parent institution.

- **Automated Valuation Models**. Automated valuation models must adhere to quality control standards designed to:
  - — Ensure a high level of confidence in the estimates produced by the models;
  - — Protect against the manipulation of data;
  - — Seek to avoid conflicts of interest; and
  - — Require random sample testing and reviews performed by a licensed appraiser.

- **Broker Price Opinions**. A broker price opinion (i.e., an estimate prepared by a real estate broker, agent, or sales person that details the probable selling price of a particular piece of real estate property) may not be used as the primary basis to determine the value of a consumer's principal dwelling for the purpose of originating a residential mortgage loan secured by that dwelling.

- **Copy of Appraisal to Borrower**. Finally, the Act amends the Equal Credit Opportunity Act to require that each creditor furnish to an applicant a copy of any written appraisal and valuation developed in connection with the applicant's application for a loan secured by a first lien on a dwelling promptly upon completion, but no later than three days prior to the loan closing (if the loan does go to closing). Currently, the creditor is required to furnish a copy of the appraisal only at the applicant's request.

Arnold & Porter represents mortgage originators and servicers in resolving issues arising under federal and state mortgage laws, as well as the fair lending laws. We also are available to respond to questions raised by the Act, or to help guide your business towards legislative and regulatory solutions. For further information, please contact your Arnold & Porter attorney or:

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