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CFPB BEGINS PUMPING OUT FINAL MORTGAGE LOAN RULES

The onslaught of mortgage-related final rules required by the Dodd-Frank Reform Act and promised by the Consumer Financial Protection Bureau has now begun. On January 10, 2013, the Bureau released the following three final rules, all of which amend Regulation Z. These final rules will be discussed at the upcoming BCG Mortgage Lending Compliance Seminar to be held in March.

Ability to Repay – Effective January 10, 2014. The final rule requires lenders to make a reasonable, good faith determination of a consumer's reasonable ability to repay a residential mortgage. The final rule provides four different ways in which a creditor can comply with the ability to repay requirement.

General Rule: Consider Specified Underwriting Factors. First, under the general rule, a creditor may determine a consumer's ability to repay a residential mortgage loan by considering eight underwriting factors: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) the monthly loan payment on the transaction; (iv) the monthly payment on any simultaneous loans; (v) the monthly payment for mortgage-related obligations; (vi) current debt obligations, alimony or child support; (vii) the monthly debt-to-income ratio or residual income; and (viii) credit history. The final rule gives detailed guidance on how creditors are to apply each factor as well as verify and document these factors based upon third-party records.

Qualified Mortgage Approach. Second, the final rule allows a creditor to meet the general ability to repay requirement by originating a "qualified mortgage." The rule generally defines a "qualified mortgage" as one that: (i) provides for regular periodic payments that are substantially equal (although payment increases are permitted in the case of adjustable-rate and stepped-rate mortgages); (ii) the monthly payments are calculated based on the highest payment that will apply during the first five years of the loan; (iii) has a total (or "back-end") debt-to-income ratio of 43 percent or less; (iv) the creditor considers the consumer's expected income or assets (excluding the value of the dwelling) and current debt obligations; and (v) does not include certain "toxic" product features, such as negative amortization, interest-only payments, balloon payments, or a loan term which exceeds 30 years. The Bureau made the point in the final rule that "no doc" or "low doc" loans and loans where the points and fees exceed three percent of the loan amount cannot be considered qualified mortgages. Note that creditors are not

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required to consider an applicant's credit history in order for a loan to be considered a "qualified mortgage."

With regard to the qualified mortgage approach, the Bureau has provided creditors a compliance safe harbor for qualified mortgages that are not considered higher-priced mortgage loans under Regulation Z Section 1026.35 – in other words, prime loans that meet the qualified mortgage criteria. If a loan meets the qualified mortgage criteria and it does not fall in the higher-priced loan category, it will be conclusively presumed that the creditor made a good faith and reasonable determination of the consumer's ability to repay. Therefore a consumer will not be allowed to sue a creditor for violating Regulation Z based on the claim that the creditor did not make a proper determination that the consumer could afford to repay the loan.

In contrast, for qualified mortgages that are considered higher-priced loans under Regulation Z (basically subprime loans), the presumption of compliance is rebuttable, meaning the consumer is allowed to show that at the time the loan was originated the consumer's income and debt obligations left insufficient residual income or assets to meet the consumer's living expenses.

Refinance Non-standard Mortgage with a Standard Mortgage. The third approach available to creditors to meet the ability to repay requirement is to refinance a "non-standard mortgage" and replace it with a "standard mortgage." A non-standard mortgage is a variable-rate loan with an introductory fixed interest rate for one year or more, a loan that provides for interest-only payments, or a negative amortization loan. On the other hand, a standard mortgage is one that calls for regular periodic payments and does not include negative amortization, interest-only payments or balloon payments. The other, more stringent requirements under the general rule for determining a consumer's ability to repay by applying the eight underwriting factors or the qualified mortgage approach do not apply in this case, to incentivize lenders to refinance borrowers out of non-standard mortgages.

Rural Creditors May Originate Qualified Mortgages With Balloon Payments. And lastly, the final rule allows certain creditors to originate qualified mortgages that include a balloon payment and still be considered to have met the requirement to make a reasonable, good faith determination that the consumer has a reasonable ability to repay the loan. The final rule provides extensive guidance regarding which creditors are allowed to use this approach (primarily lenders in rural areas) and what they have to do to comply.

Escrow Requirements for Higher-priced Mortgage Loans – Effective June 1, 2013. This final rule amends existing provisions of Regulation Z which require creditors to establish and maintain escrow accounts for at least one year after originating a higher-priced loan. Under the final rule, the time period for maintaining escrow accounts is increased to a minimum of five years. The final rule exempts from the escrow requirements "small" creditors that operate predominately in rural or underserved areas. To be eligible for the exemption, a creditor must: (i) make more than half of its first-lien mortgages in rural or underserved areas; (ii) have assets of less than $2 billion; (iii) together with its affiliates, have originated 500 or fewer first-lien mortgages during the preceding calendar year; and (iv) with certain exceptions, not escrow for any mortgages serviced by the creditor or its affiliates.

High-Cost Mortgage and Homeownership Counseling – Effective January 10, 2014. This particular final rule expands the types of loans that are covered by the Home Ownership and Equity Protection Act (HOEPA) and Section 1026.32 of Regulation Z, which are often referred to as high-cost mortgages, Section 32 loans or HOEPA loans. Most types of mortgage loans secured by a consumer's principal dwelling that meet either the APR Test or Points and Fees Test) are now covered by the rule, including purchase-money mortgages, refinancings, closed-end home equity loans and open-end home equity lines of credit (HELOC). The final rule continues to exempt reverse mortgages and initial construction loans from coverage.

The final rule revises the current APR Test and Points and Fees Test under Section 1026.32, and adds a new third test, called the Prepayment Penalty Test, for determining whether a loan is considered a high-cost mortgage loan. Currently, a transaction qualifies as a high-cost mortgage if the APR at consummation exceeds the yield on Treasury securities having comparable periods of maturity by more than eight percentage points in the case of first-lien loans, and more than 10 percentage points in the case of subordinate lien loans. A loan is currently considered to be a high-cost mortgage under the Points and Fees Test if the total points and fees payable by the consumer at or before loan closing exceed the greater of eight percent of the total loan amount or a fixed dollar amount which adjusts annually. Effective January 1, 2013 the dollar amount is $625.

Under the revised APR Test, a transaction is considered a high-cost mortgage if the APR exceeds the applicable average prime offer rate (APOR) (instead of the yield on a comparable Treasury securities) for a comparable transaction by more than:

- 6.5 percentage points for most first-lien mortgages; or

- 8.5 percentage points for a first-lien mortgage if the dwelling is personal property and the transaction is for less than $50,000; or

- 8.5 percentage points for subordinate-lien loans.

- Under the Points and Fees Test, a mortgage qualifies as a high-cost mortgage if the points and fees exceed:

- 5 percent of the total transaction amount for loans in the amount of $20,000 or more; or

- The lesser of 8 percent of the total transaction amount or $1,000 for loan transactions that are less than $20,000.

These dollar figures will be adjusted annually based on inflation.

Finally, under the new Prepayment Penalty Test, a loan is considered a high-cost mortgage if the terms of the loan or HELOC credit agreement permit the creditor to charge or collect a prepayment penalty more than 36 months after the transaction is closed or permit such fees or penalties to exceed, in the aggregate, more than two percent of the amount prepaid.

For questions regarding these final rules, contact Janet Bonnefin or Bob Olsen with our Firm's Consumer Practice Group at 949-474-1944, or email them at **JBonnefin@ABMLawFirm.com** or **ROlsen@ABMLawFirm.com**. We also encourage you to attend the BCG Mortgage Lending Seminar scheduled for this March. To access the Seminar Announcement, go to **https://www.bankerscompliancegroup.com/upcoming-seminars.php**.