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MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT of 2009

(As Passed by House of Representatives)

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I. H.R. 1728 IMPOSES DUTIES ON SEVERAL OF THE PLAYERS IN THE RESIDENTIAL MORTGAGE FINANCE SYSTEM

- Title I imposes a duty of care on and prohibits steering incentives involving mortgage originators
- Title II imposes a duty on creditors to determine a borrower's ability to repay a loan and the presence of net tangible benefit for a consumer and responsibility on assignees for violations by creditors
- Title V imposes duties on mortgage servicers
- Title VI imposes duties on appraisers
- H.R. 1728 is based on H.R. 3915, passed by the House in November 2007, with several changes

II. TO WHAT LOANS DO REQUIREMENTS APPLY?

- Applies to “residential mortgage loans”
  - Loan primarily for personal, family, or household use that is secured by mortgage, deed of trust, or other consensual security interest on a dwelling, excluding open-end and reverse mortgage loans
- Distinguish this standard from “high cost” loans under HOEPA, which are treated separately in Title III
- Note presumption for “Qualified Mortgages” in Title II

III. WHO OR WHAT IS A MORTGAGE ORIGINATOR?

- A mortgage originator is any person who takes a loan application, assists a consumer to obtain or apply for a residential mortgage loan, or offers or negotiates loan terms, for compensation.
  - “Assist” = advising on loan terms, preparing loan packages, or collecting information on behalf of the consumer
  - As written, the term would seem to exclude creditors, but not their retail loan officers
  - Excluded is one who merely performs administrative or clerical tasks (receipt/collection/distribution of information for processing or underwriting; communication with consumer to obtain information) and who does not advise consumers about loan terms (rates, fees and other costs)
  - Excluded is a person/entity that only performs real estate brokerage activities (unless compensated by or on behalf of the lender, broker, loan originator)
  - Excluded is a loan servicer, including in connection with loan modifications

IV. WHAT RESPONSIBILITIES DOES A MORTGAGE ORIGINATOR HAVE TO A CONSUMER?

- **Imposes a duty of care**, but disclaims fiduciary duty unless imposed by other law or conduct
- How is the duty satisfied?
  - Must be qualified and registered and licensed as required
    Note: federal cause of action for failure to be licensed under state law
  - Diligently work to present consumer with a range of products for which borrower likely qualifies and which are appropriate to consumer's existing circumstances, based on information known, or obtained in good faith, by the originator
    - Not required to present products offered by creditors which do not accept referrals or applications from or through such originator or products creditor does not offer to general public

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IV. (cont.)

  - “Appropriate” = Presumption if originator determines in good faith, based on then existing information and without undergoing full underwriting, that consumer has reasonable ability to repay, net tangible benefit (for refis.), and loan does not have “predatory characteristics or effects” (e.g., equity stripping, excessive fees, abusive terms).
- Provide clear disclosure of:
  - Comparative costs of loan products
  - Nature of originator’s relationship to consumer (including costs of services)
  - Relevant conflicts of interest

IV. (cont.)

- **Prohibits adverse steering** for loans
- Total amount of direct and indirect compensation from all sources to a mortgage originator may not vary, based on loan terms (other than principal amount).

IV. (cont.)

- While the prohibition nominally includes "yield spread premium or any equivalent compensation or gain," the Act would expressly allow:
  - Secondary market transactions
  - Volume-based compensation
  - A consumer to finance, including through principal <u>but not rate</u>, any permitted origination fees or costs. Thus, lenders may pay and originators may receive back-end compensation, but solely to benefit borrower. In other words, one cannot use yield spread premiums as a means to increase the compensation paid to brokers, even if such compensation would constitute reasonable value for services actually performed under RESPA
  - Originator may not arrange for consumer to finance through rate any origination fees or costs except (i) *bona fide* third party settlement charges not retained by creditor or originator or (ii) for qualified mortgages where originator does not receive any other compensation from consumer except that which is financed through rate [How to reconcile?]

IV. (cont.)

- Applies both to back-end compensation paid to brokers and compensation paid to *bona fide* employees (e.g., overages)
- Federal banking agencies to issue regulations to prohibit mortgage originators from:
  - Steering a consumer to a loan for which he/she lacks a reasonable ability to repay, to a refinancing without a net tangible benefit, or to a loan that has predatory characteristics or effects (e.g., equity stripping, excessive fees, or abusive terms);
  - Steering qualified consumers from "qualified" mortgages; and
  - Abusive or unfair lending practices that promote disparities among consumers of equal creditworthiness but different race, ethnicity, gender, or age.

IV. (cont.)

- Federal banking agencies to issue regulations to prohibit mortgage originators from: (cont.)
  - Assessing excessive "points and fees" to a consumer for the origination of a loan based on consumer's decision to finance payment through rate (but rate not permitted?)
  - Mischaracterizing the credit history of consumer or the loans available to the consumer
  - Mischaracterizing or suborning the mischaracterization of the appraised property securing the property
  - Discouraging a consumer from seeking a loan from another if the originator is unable to offer a loan that is not more expensive than a loan for which customer qualifies
- Regulations final in 12 months, effective in 18 months, but 2008 HOEPA regs not stayed

V. HOW MUST LOANS BE UNDERWRITTEN BY CREDITORS?

- In accordance with regulations to be issued jointly by federal banking agencies in consultation with the FTC, creditors must make a reasonable and good faith determination that at the time the loan is consummated:
  - Borrower has **a reasonable ability to repay the loan** according to its terms (and any other loan secured by same dwelling of which the creditor is aware) and all applicable taxes and insurance, based on verified and documented information
    - Determination must be based on, at a minimum, consideration of a consumer's credit history, current income, reasonably assured expected income, current obligations, DTI ratio, employment status, other financial reserves besides equity
    - Special considerations for non-traditional mortgages (fully indexed rate, fully amortizing payment schedule)
    - Calculated based on substantially equal amortizing payments (except for regs that permit shorter amortization schedule with balloon for qualified mortgages)
    - Special rules for refinancing current hybrid loans by same creditor

V. (cont.)

- Based on information known by or obtained in good faith by creditor, refinancing loan provides a <u>net tangible benefit to borrower</u> (excludes seconds and purchase money)
  - Standard violated if costs of refinancing exceed amount of newly advanced principal WITHOUT any corresponding changes in the terms of the refinanced loan that are advantageous to consumer
- Regulations final in 12 months, effective in 18 months, but 2008 HOEPA regs not stayed

VI. IS THERE A SAFE HARBOR?

- There is a “safe harbor” where loans that fit in the safe harbor are presumed to satisfy the new underwriting standards
- The “safe harbor” is characterized as creating a “rebuttable presumption” of compliance but may be rebutted against either the creditor or an assignee
  - What is a rebuttable presumption? [note: not an exception]
  - Eliminated negative presumption for a loan that falls outside of the safe harbors

VI. (cont.)

- Elements of qualified mortgages:
  - APR does not exceed "average prime rate for comparable transaction," as published by FRB, by 1.5 or more percentage points for first lien conforming loans and 2.5 or more for nonconforming loans based on original principal amount and 3.5 or more for second lien
  - Fully amortizing and no balloon where a scheduled payment is more than twice as large as average of earlier payments
  - No negative amortization
  - No deferral of repayment of principal or interest

VI. (cont.)

- Income and financial resources are verified and documented
- Underwriting is based on fully amortizing loan including taxes and insurance and for ARMs based on maximum rate during first 7 years
- Total debt (not limited to mortgage debt) to income ratio does not exceed amount determined by regulations
- Total points and fees do not exceed 2% (using HOEPA definition)

VI. (cont.)

- Term does not exceed 30 years
- Banking agencies directed to prescribe rules to include in definition loans that are insured by FHA or RHS, guaranteed by VA or DoA or meet GSE conforming loan limits
- In addition, very broad delegation of authority to agencies to revise, add to, or subtract from the criteria that define the safe harbors. Note the incredible power the agencies will have to determine lawful lending in the U.S.

VII. DOES THE LAW AUTHORIZE THE BANKING AGENCIES TO REGULATE UNDERWRITING FURTHER?

- Under the title "discretionary regulatory authority," the Act directs the federal banking agencies to issue joint regulations prohibiting or conditioning terms, acts or practices relating to residential mortgage loans that the agencies find to be abusive, unfair, deceptive, predatory, inconsistent with reasonable underwriting standards, necessary or proper to effectuate the purposes of Sections 129B (mortgage originators) and 129C (creditors), to prevent circumvention or evasion thereof, or to facilitate compliance with such sections, or are not in the interest of the borrower.

VIII. WHAT HAPPENS WHEN THE LAW IS VIOLATED?

- Violations of anti-steering and duty of care provisions in Title I result in monetary damages (standard TILA civil liability, as amended; see below) up to a maximum of the greater of actual damages and 3 times the amount of direct and indirect compensation and gain, plus costs to consumer
- Violations of ability to repay/net tangible benefit provisions in Title II result in:
  - Actual damages, statutory damages, and attorneys' fees based on standard TILA civil liability provisions—no enhanced damages, but doubles the statutory damages
  - Right of rescission and costs

VIII. (cont.)

- Claims against assignees may be asserted in individual actions only - no class actions against assignees, but class actions may be asserted against creditors
- No liability if consumer knowingly, or willfully and with actual knowledge, furnished material information known to be false for the purpose of obtaining such residential loan
- State attorneys general may enforce

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IX. WHAT IS RESPONSIBILITY OF CAPITAL MARKETS FOR VIOLATIONS?

- No assignee liability for the anti-steering/duty of care violations in Title I
- There is “limited” assignee liability for ability to repay/net tangible benefit violations of Title II
- Goals are:
  - To impose a responsibility on capital markets to police the market but not subject securities holders to risk of loss
  - To enable borrower to get out of a loan that never should have been made

IX. (cont.)

- Assignees are not responsible for the money damages available to aggrieved borrowers, except consumer may seek actual damages during foreclosure and after expiration of statute of limitations
- Assignees are responsible for rescission and additional costs incurred as a result of the violation

IX. (cont.)

- Who is an assignee?
  - "Securitizer" means the person who transfers, conveys, or assigns, or causes the transfer, conveyance, or assignment of, residential mortgage loans, including through a special purpose vehicle, to any securitization vehicle
  - The term "assignee" is not defined, presumably anybody in the chain of ownership prior to acquisition by securitizer, not limited to holder
  - Issuing trusts and any trustee that holds the loans solely for benefit of that securitization vehicle are excluded, as are subsequent purchasers of securities and repackagers of securities or interests therein
  - Warehouse lenders and repo participants could be included

IX. (cont.)

- Deleted from H.R. 3915: the assignee/securitizer safe harbor based in part on NJ model:
  - Assignee has policies in place limiting purchase of loans to qualified mortgage and qualified safe harbor mortgages
  - Assignee requires seller to rep and warrant in loan sale agreement that all of the loans are qualified mortgages or qualified safe harbor mortgages
  - Assignee exercises reasonable due diligence based on "adequate, thorough and consistently applied sampling procedures" in accordance with regulations to be issued
  - Language was silent on scope or method of due diligence or consequence of adverse findings

IX. (cont.)

- Borrowers cannot rescind if lender/assignee (acting in good faith) cures within 90 days of receipt of notice of violation by borrower
- Assignees may cure only if they have exercised reasonable due diligence in complying with ability to repay and net tangible benefit requirements (what does that mean?)
- Cure requires loan modification or refinancing, at no cost to consumer, to provide borrower with loan terms that satisfy the ability to repay and net tangible benefit requirements
- Cure under H.R. 3915 would have required new loan terms that satisfied the law at the time of origination. Note: lender/assignee now bears risk of change in circumstances from time of origination

IX. (cont.)

- If disagreement over what constitutes a cure, the creditor, assignee, or securitizer may provide the cure subject to consumer's continuing right to challenge for 6 months
- Must consumer first look to creditor, then assignee and finally securitizer?
- If creditor, assignee, or securitizer <u>cannot</u> provide rescission, liability shall be met by providing financial equivalent of rescission plus costs
- Rescission may be raised as a defense to foreclosure even though neither servicer nor holder is legally responsible for cure or rescission

IX. (cont.)

- Authorizes the transfer of the loan to the responsible party subject to rights of consumer - intended to trump other laws like REMIC
    - Punitive damages if fail to repurchase?
- Right to bring original action survives for greater of 3 years and 1 year after the loan first adjusts or converts to an amortizing payment schedule, but no more than 6 years
- Exception for right to pursue actual damages following expiration of statute of limitations when loan is in foreclosure

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X. WHAT OTHER GENERAL RESTRICTIONS DOES THE BILL PROVIDE?

- Directs federal banking agencies to prescribe regulations to require any creditor to retain an economic interest in a material portion (at least 5%) of the credit risk for a loan it makes that it sells or conveys to third parties
  - Prohibits creditor from hedging or transferring the credit risk
  - Applies without regard to actual reason for default or loss
  - Regulations must specify the permissible forms of required risk retention (e.g., first loss or vertical slice) and minimum duration
  - Permits regulators to provide exceptions or adjustments and to apply the requirements to securitizers in addition to or in place of creditors

X. (cont.)

- Prohibits prepayment penalties for residential mortgage loans that are not qualified mortgages
- Qualified mortgages may not include penalties for prepayment that provide penalties in excess of 3 percentage points in first year, 2 percentage points in second year, 1 percentage point in third year, and any penalty thereafter (note: relationship to high cost loans under Title III)
- Prohibits financing of single premium credit insurance in any residential mortgage loan

X. (cont.)

- Prohibits mandatory arbitration or any other nonjudicial procedures as the method for resolving controversy or settling claims (includes open end but excludes reverse)
  - Does it prohibit nonjudicial foreclosure?
- Provides that any successor in interest following foreclosure takes subject to existing leases to permit tenant to occupy premises until end of remaining term
  - Lease must be *bona fide*
  - No written lease – 90 days
- Prohibits negative amortization loans (excluding reverse loans) <u>unless</u> certain conditions are satisfied

XI. DOES THIS LAW PREEMPT STATE LAW?

- No preemption for loan originators in Title I
- No preemption for creditors in Title II
- Very limited preemption for assignees under Title II
- No federal preemption in Title III

XI. (cont.)

- Liability of assignees/securitizers under Section 129B(d) supersedes any state law or application thereof that provides additional remedies against any assignee, securitizer, securitization vehicle, and the remedies described constitute the sole remedies against any assignee, securitizer, or securitization vehicle, for a violation of ability to repay/net tangible benefit or any other state law the terms of which address that specific subject matter.
- Exceptions - Does not limit:
  - State laws that provide defenses to foreclosure
  - Injunctive relief

XII. HOW DOES H.R. 1728 TREAT HIGH COST LOANS?

- Would lower the points-and-fees threshold (from 8% to 5% for most loans), and would lower APR threshold to match regulations
- Would add third HOEPA trigger: Loan with prepayment penalties after more than 36 months or that exceed 2% of amount prepaid
- Would apply to purchase money and open-end loans
- Would expand "points and fees" to include back-end broker compensation, certain prepayment fees
  - Excludes up to 2 *bona fide* discount points but only for lower interest rate loans
  - Excludes conventional prepayment fee for lower APR loans
  - Excludes title fees and premiums when creditor receives indirect compensation through profit distribution in compliance with RESPA
- To become effective 6 months after enactment, and to HOEPA loans consummated after the end of that 6 month period.

XIII. WHEN WOULD BILL TAKE EFFECT?

- The bill has only been passed in the House
- If enacted, would apply only to loans made on or after the effective date
- Must regulations first be enacted?