Consumer Compliance Boot Camp - Are you ready for 2014?

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Dixon, Davis, Bagent & Company Seminar

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Consumer Compliance Boot Camp

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Consumer Compliance Boot Camp Agenda

- Ability to Repay and Qualified Mortgage
- Loan Originator Compensation Rules
- Appraisal Rules for Higher Priced Mortgages
- Fair Lending Issues Related to New Mortgage Rules
- Tips for Preparing for your 2014 Examination Cycle

ABILITY-TO-REPAY RULE

- Background:
  - Implement standards to require that creditors assess a borrower's ability to repay on a mortgage loan
  - Defines and establishes certain protections from liability under this requirement for "qualified mortgages"
  - Implement other Consumer Protections (limits prepayment penalties)
  - Applies to all close end residential loans with certain exceptions
- Effective Date:
  - January 10, 2014 (Less the 5 months)

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ABILITY-TO-REPAY RULE

- Scope – “Covered Transactions”:
  - All consumer-purpose, closed-end loans secured by a dwelling
    - Purchase money loans
    - Refinance
    - Home equity loans
- Not “Covered Transaction”:
  - Home Equity Line of Credit (HELOC)
  - Reverse mortgage
  - Timeshare plans
  - Temporary or “Bridge” loans (less than 12 months)
  - Construction-to-permanent loans
  - Business purpose loans

ABILITY-TO-REPAY RULE

- General Ability-To-Repay
  - A creditor must not:
    - “make a loan that is a covered transaction unless the creditor makes a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms.” (Regulation Z; 12 CFR 1026.43 (c) (1))
- How does creditor show “reasonable and good faith determination”?

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ABILITY-TO-REPAY RULE

- Minimum Underwriting Factors to be considered:
  - (1) current or reasonably expected income or assets;
  - (2) current employment status;
  - (3) monthly payment on the covered transaction;
  - (4) monthly payment on any simultaneous loan;
  - (5) monthly payment for mortgage-related obligations;
  - (6) current debt obligations, alimony, and child support;
  - (7) the monthly debt-to-income ratio or residual income; and
  - (8) credit history.
- These factors are not intended to be comprehensive underwriting standards.

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ABILITY-TO-REPAY RULE

- Consequences of Non Compliance with ATR Rule
  - Regulatory scrutiny like any other consumer compliance violations
    - Exam ROE write & MRA
    - Possible enforcement action (including CMP)
  - Borrower has private cause of action to recover damages equal to all finance changes & fees paid in first 3 years of the loan plus legal fees
  - Borrower may assert as a set off or recoupment claim in foreclosure, even after statute of limitations expires
- Longer Statute of Limitations Period
  - Three year SOL compared to one year SOL for most TILA violations

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ABILITY-TO-REPAY RULE

- How are ATR and QM related?
  - QM entitled to presumption of compliance with ATR requirements
- Two types of presumptions:
  - “Safe Harbor” - for non “higher priced” mortgage loans
    - conclusively presumed that creditor complied with ATR requirements because is QM
  - Rebuttable Presumption” for “higher priced” mortgage loans
    - presumed that creditor complied with ATR requirements because is QM, but consumer has opportunity to provide evidence that creditor did not make a “reasonable and good faith determination” of ability to repay
    - Burden of proof on consumer
  - What is Higher Priced Loan:
    - Any first-lien mortgage with an APR of:
      - 1.5% or more above the average prime offer rate for a comparable mortgage; and
      - 3.5% or more above the average prime offer rate for a comparable mortgage by certain small creditors
  - Any second-lien mortgage with an APR of 3.5% or more above the average prime offer rate for a comparable mortgage

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ABILITY-TO-REPAY RULE

- 5 Categories of QM
  - Standard QM
  - Temporary “government patch” QM
  - Balloon Payment QM
  - Small Creditor QM (New)
  - Small Creditor Temporary Balloon Payment QM (New)

ABILITY-TO-REPAY RULE

- Attributes of Standard QM:
  - meets the ability-to-repay criteria
  - has regular periodic payments that are substantially equal (no negative amortization, interest only or balloon payments)
  - Maximum loan term of 30 years
  - total points and fees cannot not exceed 3% for loans exceeding $100,000 (varying limits for smaller loans)
  - the borrower's debt to income ratio cannot be not greater than 43%

ABILITY-TO-REPAY RULE

- Temporary Government Patch QM
  - Loan must be eligible for:
    - Purchase by a GSE while the GSE under conservatorship or receivership (FNMA, FHLMC); or
    - Insurance or guaranty by HUD, VA, USDA or RHS
  - Only requires "eligibility"; no requirement that loan be purchased, insured or guaranteed
- Other Attributes
  - Regular, periodic payments that are substantially equal; (no negative amortization, interest-only payments or balloon payments)
  - Loan term maximum 30 years
  - Points and fees maximum 3% (adjusted upward for small loans)
  - 43% DTI does not apply

ABILITY-TO-REPAY RULE

- Temporary Government Patch QM Sunset
  - GSE Eligible expires earlier of:
    - When conservatorship or receivership ends; or
    - January, 2021 (7 years post effective date)
  - Agency insured or guaranteed expires earlier of:
    - Agency establishes own QM standards; or
    - January, 2021

ABILITY-TO-REPAY RULE

- Balloon Payment QM
  - Eligibility:
    - Previous calendar year, 50% of its first-lien covered transactions on properties in "rural" or "underserved" counties;
    - Previous calendar year originated 500 or fewer first-lien covered transactions; and
    - Less than $2 billion assets
    - Must be portfolio loan and cannot sell 3 years
- Other Attributes
  - Scheduled payment substantially equal (no negative amortization or interest only)
  - Minimum 5 year term - Maximum 30 year term
  - DTI ratio and income verified – but no 43% DTI required
  - Points and fees less than 3%

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ABILITY-TO-REPAY RULE

- Small Creditor QM
  - Eligibility
    - Less than $2 billion assets.
    - Previous calendar year originated 500 or fewer first-lien covered transactions.
    - No rural or underserved requirement
    - Must be portfolio loan and cannot sell for 3 years
- Other Attributes
  - Scheduled payments substantially equal.
  - Maximum 30 year term.
  - DTI ratio and income verified – but no 43% DTI required.
  - No negative amortization or interest only.
  - Points and fees less than 3%.

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ABILITY-TO-REPAY RULE

- Small Creditor Temporary Balloon Payment QM
  - Eligibility and Attributes:
    - Same as standard Balloon Payment QM except no rural or underserved requirement
- Sunset
  - Expires on January 10, 2016 (2 years from effective date)

ABILITY-TO-REPAY RULE

- Other Key Provisions:
  - Limitation on Prepayment Penalties
    - Only for certain fixed rate qualified loans
    - Can only apply in the first three years
    - Must provide borrower an alternative loan without a prepayment penalty
- Record Retention Period
  - 3 years rather than 2 like other TILA requirements

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LOAN ORIGINATOR COMPENSATION RULES

- Purpose:
  - Implements requirements and restrictions imposed by the Dodd-Frank Act concerning loan originator compensation; qualifications of, and registration or licensing of loan originators; compliance procedures for depository institutions; and mandatory arbitration amongst other items.
  - Establishes tests for when loan originators can be compensated through certain profits-based compensation arrangements (i.e. 401K and other deferred/non-deferred compensation plans).
  - Exempts payments to loan originators when a consumer pays upfront points or fees in the mortgage transaction from Dodd-Frank Act restrictions on dual compensation.
- Scope:
  - Applies to all close-end consumer credit transactions secured by a dwelling (excluding HELOC and timeshare plans)
- Effective Date:
  - Amended to January 1, 2014, <u>except for mandatory arbitration and waiver of federal COA requirements became effective on June 1, 2013</u>

LOAN ORIGINATOR COMPENSATION RULES

- Who is a Loan Originator?
  - Takes application for consumer credit
  - Offers, arranges, assists in obtaining or applying to obtain consumer credit
  - Negotiates terms of consumer credit
  - Otherwise obtains or makes an extension of consumer credit for another
- Can administrative and clerical personnel be considered a Loan Originator?
  - Takes application for consumer credit trigger treatment as LMO?
  - Responding to customer inquiries and providing general information trigger treatment as LMO?
  - Clarification of the definition of “credit terms”

LOAN ORIGINATOR COMPENSATION RULES

- Key Provisions:
  - Prohibition Against Compensation Based on the “Term of a Transaction” or “Proxy of a Term of the Transaction”
    - Clarifies meaning of a “term” or a “proxy for a term of the transaction”
    - Cannot base compensation on such items as interest rate, APR, collateral type, fees and charges for steering toward certain products or services, etc.

LOAN ORIGINATOR COMPENSATION RULES

- Key Provisions:
  - Compensation Based on Profits Derived from Mortgage Related Business
    - Final rule generally prohibits loan originator compensation based on profits
    - However, finally clarifies that contributions to defined benefit plans and retirement plans, such as a 401K, are permissible
  - No Prohibition on Borrower Payment of Upfront Points and Fees
    - Allows Banks to charge points and fees to a borrower in cases where the Bank and not the consumer are compensating the loan originator

LOAN ORIGINATOR COMPENSATION RULES

- Key Provisions continued:
  - Loan Originator Qualification Requirements
    - Requires that all loan originators be “qualified”
    - What are Banks required to do?
  - Prohibition on Mandatory Arbitration Provisions
  - Prohibition on Waiver of Federal Causes of Action

New Appraisal Rules

Appraisal Rules for Higher-Priced Mortgage Loans under Regulation Z

- Requirements:
  - New Rule only allows Lenders to make higher-priced mortgage loans if:
    - Lenders receive an appraisal from a certified/licensed appraiser; and
    - The appraiser conducts a physical inspection of the inside of the property.
  - Requires lenders to make certain new disclosures during the application stage regarding the appraisal and a borrower's ability to receive a copy
    - Disclosure required within three business days after receipt of application
    - Have to provide a copy of the appraisal three days before consummation or within 30 days after denial of the application
  - Second Appraisal Required for "flipped" properties
  - Safer Harbor – New Appendix N
  - Exempt Loans
- Effective Date of January 18, 2014

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Fair Lending Issues Related to New Mortgage Rules

- Most fair lending have been based on disparate treatment claims
- Potential Impacts of ATR and QM Rules on Lending Patterns
  - Decrease in availability of non-QM loans may disproportionately affect low-income populations and certain geographic areas
  - Requirement that underwriting standards be applied consistently could impact lender programs to reach underserved populations through non-QM loans
- What are the Regulators saying?

Preparing for 2014 Examination Cycle

- 9 Things Your Institution Should Be Doing To Prepare
  - (1) Monitor guidance and updates from CFPB and your primary federal regulator prior to and after Effective Date; assign appropriate level personnel to monitor and report to management and Board
  - (2) Review new compliance procedures when available – the regulator's playbook
  - (3) Review and modify, as needed, mortgage loan underwriting process to ensure, at a minimum, cover the 8 ATR factors
  - (4) Implement Reg. Z, Appendix Q descriptions of "debt" and "income

Preparing for 2014 Examination Cycle

- 9 Things Your Institution Should Be Doing To Prepare (cont.)
  - (5) Review existing loan originator compensation programs, policies and practices, and modify or adjust, as needed to comply with new rules; communicate changes to affected personnel
  - (6) Review existing employment agreement, service agreements, management agreements and other documents relating to MLO compensation and amend, as needed; consult legal counsel on any sticky contract issues
  - (7) Train and empower compliance review / audit staff to test compliance with new rules prior to Effective Date

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Preparing for 2014 Examination Cycle

- 9 Things Your Institution Should Be Doing To Prepare (cont.)
  - (8) Establish, or maintain, open line of communication line with primary federal regulators; utilize regulators as consultants
  - (9) Get your Board involved; train them in basics of new rules and requirements; regulators will expect directors to have general basic understanding of new rules

Questions?

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