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The New World of Mortgage Regulation
A Look Back - A Look Around and a Look Forward

By

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I. A look back - where did it begin?

- Consumer protection legislation developed in a piecemeal fashion – individual acts answering individual needs

- TILA & RESPA - developed separately in 1968 and 1974, respectively

- Primary oversight of consumer lending and mortgage lending was divided between different agencies - Federal Reserve (TILA), HUD (RESPA), Federal Trade Commission (several acts), plus OCC, FIDC, and others.

- Sometimes the same regulation was administered by two or more agencies

- Little regulatory cooperation - no "interagency" rule making or guidance

- In some instances, how to comply and what rules applied depended upon who you were: bank, non-bank

- Some areas (licensing) reserved to states

- Some areas (servicing) not regulated at all

- No coordination between different consumer products - credit cards, pawn and payday lending, installment sales

The first big crises - the S & L failures

- The first "sub-prime" crises
- Congress responded with first set of "fix" legislation
- Servicing addressed (because of frequency of servicing transfers) - the RESPA amendments (the Cranston-Gonzalez National Affordable Housing Act (1990))
    - escrow accounting rules
    - servicing transfer regulations (a legislative fix of traditional hello/goodbye process)
    - credit protection in servicing transfers
    - created the Federal Housing Finance Agency - to regulate and examine FreddieMae and FannieMae
    - ability to send Qualified Written Requests - - question your servicer with credit protections
- Home Ownership and Equity Protection Act (HOEPA) for TILA (1995)
    - created "Section 32" of TILA - a new type of loan where: (a) fees exceed 8% of loan amount, or (b) APR is 10% more than comparable treasury security (High cost/High Fee Loans)
    - restricted balloons and pre payment penalties and negative amortization
    - required loans to be underwritten with ability to repay
- Tightened control on banks and other depository lenders - - Remember FIRREA? (the Financial Institution Reform, Recovery and Enforcement Act (1989)
    - new appraisal standards
    - licensing and qualification of appraisers
    - credit controls at depository lenders
- Problem solved - - Right?

II. A look around - the credit train wreck and the immediate aftermath

- The second credit crisis of 2008 - 2009 happened for many reasons - - but the rise of "subprime" mortgages was the easiest target
    - until approximately 2001, close to 70% of residential mortgages were Fannie Mae, Freddie Mac or FHA/VA loans
    - at the apex of the subprime "boom, 80% of residential mortgages originated were "subprime"
    - I define "subprime" as loans that were not underwritten to "agency" standards for "full doc" submission
- The immediate response of Congress was to pass two Acts: The Safe Act and The Mortgage Disclosure Improvement Act (MDIA)
- The Safe Act "nationalized" broker/originater licensing
    - The Secure and Fair Enforcement for Mortgage Licensing Act (2008)
    - individual states were required to amend state statutes to match SAFE requirements
    - national database so we know if a bad actor moves from one state to another
    - a universal set of "disqualifications"
    - states continue to regulate licensing (entity licensing)
- The Mortgage Disclosure Improvement Act (2008) - MDIA
    - who really understands a TILA statement or GFE?
    - designed to slow down velocity of transaction - in the "Glory Days", loans could close within a few days of application (and the results showed)
    - transactions slowed down because there is now a mandatory 7 day wait period between disclosure and closing
    - there is a mandatory re-disclosure if things change (3 days)

- TILA changes:
  - payment box
  - no right to refinance
  - better disclosure of "worst case" ARM payments and other non-standard features

- RESPA changes
  - new GFE "shopping" worksheet
  - required re-disclosure

- TILA - created a new (3rd) category of loan - higher priced mortgage loan
  - definition: loans with APR 1.5% (for 1st liens) or 3.5% (for 2nd liens) above average prime offer rates
  - APOR is "average " rate for prime loans
  - if HPML, then:
    - lender must escrow
    - must underwrite ability to repay (balloon mortgages)
    - require verification of income
    - no prepayment penalty if ARM

- Other TILA changes

  - appraisal independence
  - prohibit "pyramid late fees"
  - prohibition on charging fees until disclosures provided

- Problem solved - Right?

III. A look ahead - the "real" solution

- Dodd - Frank - 2300 pages of answers to the financial services mess - The Consumer Financial Protection Act (2010)

- Main component of DF (as to residential lenders)

  - creation of Consumer Financial Protection Bureau (CFPB)

  - unity of regulatory authority: one agency, one set of regulations, all lines of business (residential lending to payday/pawn transaction)

  - mandatory regulatory overhaul

- The CFPB - Consumer Financial Protection Bureau

    - independent, modeled after Federal Reserve - legislature has no control over budget, ruled by Board of Governors

    - role is to be consumer’s advocate distinct from industry

    - unity of regulations - all those regulations which had been ‘parked” with an agency or divided between agencies were given to CFPB.

    - regulatory agenda

        - mandatory regulations (July 21, 2012 effective January 21, 2013)

        - optional regulations

    - First, what will not change?

        - TILA will continue to have three types of loans which restricts loan condition and terms - HOEPA (Section 32), HPML’s and everything else

        - Safe Act - pretty much done

        - Unity of TILA and GFE (mandatory regulation). The now separate forms will become one in hopes of clarifying the true cost of mortgages (i,e, better demonstrating to consumers the trade off between costs and APR (interest).

- What will change?

    - Mortgage Servicer Regulations - best practices based on AG settlements with major banks - optional regulation, but important to CFPB

    - Unity of TILA & GFE - while two separate Regulations, there will now be one form displaying “credit costs” (i.e., APR and finance charge) and “closing costs” (dollars out-of-pocket to close). The HUD-I Settlement Statement will now be combined into one statement

    - Ability to Repay: All residential mortgage loans must be underwritten with the ability to repay - - violation of this will allow borrower to sue lender-assignees of loan

- the Qualified Mortgage Loan (QML)
  - a QML is a loan when ability to repay is presumed in some way
    - QML characteristics include no negative amortization verified income and assets, fully amortizing, points and fees less than 3% of loan debt to income ratio regulated by Fed.
    - safe harbor or rebuttable presumption?
  - The Qualified <u>Residential</u> Mortgage Loan (QRML)
    - affects lender's "risk retention" for sale of loans in secondary market - if not a QRML origination must maintain 5% of loan amount "at risk"
  - Appraiser Independence - for the post part already implemented
  - Loan Officer Compensation - steering
    - no compensation can be based on loan terms other than size of loan
    - compensation can only be paid by one party (lender or consumer, but not both)
    - no "steering" - - officer must place customer in product which is in "best interest" of customer
    - no compensation based on APR or interest rate