



**Summary of Key Provisions:
Dodd-Frank Wall Street Reform and Consumer
Protection Act (Pub. L. 111-203)
Title XIV: “Mortgage Reform and Anti-Predatory
Lending Act” Subtitles A-C: Mortgage Originations**

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I. WHO’S DOING WHAT AND WHEN? WHAT REGULATORS WILL BE INVOLVED IN MORTGAGE RULES?

Effective Dates of Title XIV Subtitles A-C: Generally, a provision of Title XIV is to become effective when the final regulations implementing the provision are effective. If no regulation implementing a provision of the law has been issued by January 21, 2013,¹ that provision becomes effective as of that date. §1400(c)(2),(3).

Outside time limits for mandatory rules: By law, the mandatory rules to be promulgated under Title XIV must be finalized no later than 18 months from the “designated transfer

¹ The statute pegs the outside time at 18 months after the designated transfer date (now set for July 21, 2011), which would put it at January 21, 2013.

date” of July 21, 2011, or approximately January 21, 2013, with an effective date no later than 12 months after the issuance of the final rule. (That would imply an outside time limit for rules to become effective of January 21, 2014). § 1400(c)(1).

When will the rule-making start? The FRB has the authority to begin the rule-making process now, and has indicated it will do so.² These rules are part of Truth in Lending Act amendments, and TIL rule-making will transfer to the CFPB on July 21, 2011.³ The rules, in whatever stage of development, will then become CFPB’s job. If they have been issued by the FRB as proposed rules for comment, they will be deemed to be CFPB proposals. §1063(j). If rules have been published as final, but are not yet effective, they will become effective as a Bureau rule as of the date the Board set in the final rules. §*Id.*

NOTE: Throughout this outline, references to “FRB/CFPB” in the context of rule-making means FRB prior to July 21, 2011 (the designated transfer date), and the CFPB after that date.

II. KEY DEFINITIONS AND CONCEPTS

A. “Qualified mortgage” [“QM”] and “qualified residential mortgage” [“QRM”] -- mortgages with less risky features (as defined by statute and regulation) entitled to certain legal benefits intended to serve as incentives for the market to make sound loans. A key lesson of the crisis was that perverse market incentives encouraged the sale of mortgage loans that were intrinsically more at risk of default, irrespective of the borrower, and more expensive. Since these were more profitable (until they imploded), these more risky, more expensive loans “crowded out” safer, more sustainable loans from the supply side. The concept behind the “qualified mortgage” is to give the market incentives to make safer, more sustainable loans. It’s the “carrot” for sensible lending in the reform bill.

The concept appears in two different titles in Dodd-Frank, with different incentives in each title. In Title XIV, the mortgage reform title, a “qualified mortgage” as defined there gives lenders a presumption of compliance with the Act’s new ability-to-pay provision and certain other benefits. In Title IX, a “qualified residential mortgage” definition is established that will serve as an exception to the “risk-retention” provisions in the reforms to the asset-backed securitization process. (The risk-retention requirement is designed to require that the originators of MBS have some “skin in the game.” This flows from another lesson of the crisis: the model known as “originate to sell” [making loans to sell on to the secondary market] meant that originators and securitizers had no incentive to make soundly underwritten, sustainable loans, as the risk of default was

² See, e.g. FRB Final rule to protect mortgage borrowers from unfair, deceptive and abusive loan originator compensation practices, Supplemental Information, p .3, Docket R-1366 (August 16, 2010), available at

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100816d1.pdf> ; 75 Fed. Reg. 58509 (September 24, 2010).

³ Designated personnel from the FRB, as well as from other agencies whose consumer protection responsibilities will shift to the CFPB, will be transferred to the new Bureau. *Dodd-Frank, Title X, Subt. F.*

passed on to investors and diffused.) Table 1, below, summarizes the differences between the two in the statute.

1. Truth in Lending “Qualified mortgage” [“QM”] –

For purposes of compliance with the new Truth in Lending provisions, the Title XIV definition of “qualified mortgage” is the key.

“Qualified mortgages” --

- are entitled to a presumption of compliance with the new “*ability to pay*” requirement. *Dodd-Frank §1411, adding 15 USC 1639C(a); (see IV-A, below).*
- are *permitted to charge prepayment penalties*, with certain restrictions: (not all qualified mortgages are eligible to do so). (*see IV-B, below*) ;
- are a key part of the *anti-steering provision*. (regulations must prohibit originators from steering eligible consumers from “qualified mortgages” to non-qualified mortgages. *Dodd-Frank §1403, adding 15 USC 1639B(c)(3)(B); (see III-C, below)*)

A “qualified mortgage” as defined by TIL meets these criteria:⁴

- no negative amortization or deferred principal repayment (with specified exception);
- no balloon payment (with specified exception);
 - rules may allow balloon under prescribed conditions, including underwriting standards, and that the loan is made by a creditor that operates in rural or underserved areas, retains the loans in portfolio, and meets loan origination volume and asset size thresholds set by rule.
- verified and documented sources for repayment ability
- for fixed rate loans; underwriting on fully amortizing and PITI and assessments;
- for ARMs, underwriting at max rate during first 5 years, fully amortizing over the loan term, and PITI and assessments;
- complies with regulatory guidelines for DTI or alternative measure
- points and fees (defined) = 3% or less, with some carve-outs
 - HOEPA definition of points and fees, (§1602(aa)(4), as amended by Dodd-Frank §1431), (*see VI-A, below*)
 - “QM” definition excludes true rate-reducing discount points within prescribed limits
 - Regulations may adjust for smaller loans
- max. 30 year term, except as extended by rule
- for reverse mortgages covered by ability to repay rule, QM criteria to be set by rule.
- FRB/CFPB may revise, add to, or subtract from these criteria to assure that responsible, affordable credit is available in a manner consistent with purposes of new §§1639B and 1639C, to prevent evasion, or facilitate compliance.
 - HUD, VA, Dept. of Agriculture and Rural Housing Service have same mandate to issue rules defining “qualified mortgages” for specified

⁴ Dodd-Frank §1412, adding new TIL §1639C(b)(2)(A).

mortgages that are insured, guaranteed or administered by each of those agencies, in consultation with FRB/CFPB.

2. SEC Act “Qualified Residential Mortgage” [“QRM”]

For purposes of understanding the larger securitization market incentives, the “skin in the game risk retention” definition will be perhaps even more important. Banking regulators and the SEC will jointly prescribe rules to require securitizers to retain at least 5% of the credit risk, with exceptions tied to “qualified residential mortgage” status.

NOTE: A full discussion of this requirement is beyond the scope of this summary: it is included here simply to alert the reader to the existence of two distinct definitions and uses of the concept in the mortgage market arising from Dodd-Frank reforms.

Table 1: “Qualified mortgage” (QM) and qualified residential mortgage” (QRM) – Comparison of Truth in Lending concept and SEC “skin in the game” risk-retention requirement for securitization

	Truth in Lending: Dodd-Frank § 1412, adding 15 U.S.C. §1639C(b)(2)(A)	SEC: Dodd-Frank §941, amending 12 USC 78a et seq.
Incentive benefit to “qualified mortgage” (QM) or “qualified residential mortgage” (QRM)	1. QM entitled to rebuttable presumption that the loan meets the statutory “ability to repay” requirement of new 15 USC §1639C(a) (<i>See IV-A-2, below</i>). 2. Prepayment penalties permitted in prime, fixed rate QM. (<i>See IV-B & tbl 4, below</i>) 3. Reduces potential exposure for liability for improper steering, (<i>See III-C, below</i>)	Regulations require at least 5% risk retention but QRM has full exception from that requirement.
Regulatory authority	FRB/CFPB is to implement by rule, and can “revise, add to, or subtract” from the statutory criteria, consistent with ensuring responsible, affordable credit is available, that purposes of new §§1639B and 1639C are achieved, to prevent evasion, and to facilitate compliance. (DF §1412, adding new 15 USC §1639C(b)(3)(B) <i>Authority will transfer to CFPB 7-21-2011.</i>	FRB, FDIC, OCC, SEC, HUD, and FHFA to jointly prescribe regulations defining QRM no later than 270 days from 7/21/10. Chairman of the Financial Stability Oversight Council (Sec. of the Treasury) to coordinate joint rule-makings.
Criteria defining a qualified mortgage	i. no negative amortization or deferred principal repayment (with specified exceptions ⁵); ii. no balloon payment (with	Above regulators to define “QRM,” taking into account underwriting and product features that historical loan performance

⁵ The authorization for balloons is limited, e.g. applies only to creditors meeting specified criteria and must be held in portfolio. *Dodd-Frank* §1412, adding new §1639C(b)(2)(E).

	<p>specified exception, <i>see</i> note 5);</p> <p>iii. verified and documented sources for repayment ability</p> <p>iv. for fixed rate loans; underwriting on fully amortizing and PITI and assessments;</p> <p>v. for ARMs, underwriting at max rate during first 5 years, fully amortizing over the loan term, and PITI and assessments;</p> <p>vi. complies with regulatory guidelines for DTI or alternative measure</p> <p>vii. points and fees (defined) 3% or less, with some carveouts. (<i>see VI-A, below</i>)</p> <p>viii. max. 30 year term, except as extended by rule</p> <p>ix. for reverse mortgages covered by ability to repay rule, QM criteria to be set by rule.</p>	<p>data indicate have lower risks of default, such as documentation and ability to pay standards (front and back-end DTI, residual income); existence of insurance on loans over 80% LTV, payment shock on ARMs, balloons, neg am, etc.</p> <p><i>This definition cannot be “broader” than the TIL definition and Reg. Z definition.</i></p>
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B. “Residential Mortgage Loan” definition –

The mortgage origination provisions of Subtitles A and B (originator compensation, anti-steering, and ability to repay) apply to “residential mortgage loans,” – essentially closed-end consumer loans secured by a dwelling. (It does not have to be the consumer’s principal dwelling.) *D-F §1401, adding TIL 15 USC §1602(cc)(5).*

The elements of the definition are:

- a “consumer credit transaction,”⁶
- secured by a mortgage, deed of trust or other equivalent consensual security interest on a dwelling⁷ or on residential real property that includes a dwelling
- **excludes** HELOCs; and
- **excludes** time shares⁸ for certain purposes, including the ability to repay, originator compensation, and anti-steering provisions, new closed-end disclosures requirement by D-F §1419, the new Dodd-Frank requirement for periodic mortgage statements (D-F §1420), and the defense to foreclosure provision (D-F §1413)

Note: “Residential mortgage loan,” which includes refinances and *closed-end* home equity loans (but not open-end home equity loans), should not be confused with the existing TIL definition of “residential mortgage *transaction*, 15 USC

⁶ See TIL definitions of “consumer” and “credit” 15 USC §1602(e), (h); Reg. Z, §226.2(a)(11), (12), (14).

⁷ “Dwelling” includes 1-4 family housing units, mobile or manufactured homes, trailers used as homes, and condos, etc. 15 USC §1602(v); Reg. Z, §226.2(a)(19)

⁸ The text excludes “extensions of credit relating to a plan” described in 11 USC §101(53D), which are time shares.

1602((w); Reg. Z, 226.2(a)(24), which encompasses only purchase-money mortgages.⁹ ...should not be confused, but undoubtedly will be.

C. “Mortgage originator”

Provisions of Dodd-Frank apply to a broader class of originators than those that meet TIL’s more narrow definition of “creditor.”¹⁰ Brokers are covered – both third party brokers and those brokers involved in table-funded transactions that are nominally “creditors” for TIL purposes. Loan-originating employees of retail lenders also seem to be encompassed by the term.¹¹ *Dodd-Frank, §1401, adding 15 USC §1602(cc)(2).*

1. Definition – General –

- Any person who, for direct or indirect compensation or gain, or in the expectation thereof, takes a “residential mortgage loan” application, assists a consumer in obtaining or applying for such a loan, or offers or negotiates the terms of such a loan, including those who advertise themselves as such;
- **excludes** administrative employees of an originator, and employees of manufactured home sellers, as long as they don’t take an application, advise a consumer on rates and terms, or offer or negotiate the mortgage terms.¹²
- **excludes** licensed real estate brokers that “only perform real estate brokerage activities”, unless it is compensated by a lender, broker, other mortgage originator, or agent of any of those. (emphasis added). [i.e. real estate brokers who only sell houses and not the financing not captured, but if they sell the mortgage as well, to that extent, likely to be covered.¹³]
- **excludes** entity (person, estate or trust) that provides seller-financing loans for 3 or fewer properties or less a year, provided that it is not the contractor, and each of the loans is fully amortizing, has a fixed rate for at least 5 years, and for which the seller has determined that the buyer has a reasonable ability to repay; (The FRB/CFPB may prescribe other criteria.)

⁹ TIL’s rescission right, for example, does not apply to the purchase money “residential mortgage transaction”, but only to refinances, 15 USC § 1635(e)(1), nor does HOEPA’s special provisions under current law, 15 USC §1602(aa)(1). See generally National Consumer Law Center, *Truth in Lending* §§ 6.2.6.1, 9.2.4.1 (6th Ed. 2007 and supp.), hereafter *NCLC TIL*. (Dodd-Frank removed the HELOC exception from the high-cost HOEPA definition. See VI-A, below.)

¹⁰ TIL’s definition of “creditor” is limited to the person to whom the obligation is “payable on its face.” 15 USC § 1602((f); Reg. Z, § 226.2(a)(17). This excludes the true lender in table funded transactions, as well as third-party brokers that do not make table-funded loans. See generally NCLC, *Truth in Lending* §2.3.5.

¹¹ This is not explicit in Dodd-Frank. However, it is explicit in the new FRB compensation rules, §226.36(a)(1), as amended, and the Board says that its definition is consistent with Dodd-Frank §1401, “which defines ‘mortgage originator to include employees of a creditor, individual brokers and mortgage brokerage firms, including entities that close loans in their own names that are table-funded by a third-party.” See FRB Final rule to protect mortgage borrowers from unfair, deceptive and abusive loan originator compensation practices, Supplemental Information, p .34-35, Docket R-1366 (August 16, 2010), available at

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100816d1.pdf>; 75 Fed. Reg. 58509, 58518 (September 23, 2010).

¹² Caveat: due to an excessive number of “nots” in Section 1401, adding new 1602(cc)(2)(B), the reader is advised to independently verify this characterization of the manufacturer home retailer employee provision.

¹³ That would be consistent with the partial exclusion for real estate agents from CFPB jurisdiction: their real-estate selling activities are exempt from CFPB, though their mortgage-selling activities are covered. *D-F §1027(b).*

- **excludes** servicers, servicer employees, agents and contractors, including in loan mod and work-out context;

2. “Creditors” as mortgage originators --

The application of the term “mortgage originator” to “creditors” as TIL defines them¹⁴ is more complicated.

- Creditors are subject to Dodd-Frank anti-steering provisions;
- “Creditors” are generally excluded from definition for purposes of the originator compensation provision, but this probably will be interpreted just to exclude transactions between creditors and secondary market purchasers, to which consumers are not a party;¹⁵
- Creditors in table-funded transactions are subject to the compensation provisions, as well as anti-steering provision;
- Individual employees of “creditors” and mortgage broker firms are covered by the term, for purposes of the originator compensation provisions as well as anti-steering provision, provided the employee otherwise meets the general definition, *see note 11*.

III. ORIGINATION STANDARDS – ORIGINATORS: Duty Of Care, Originator Compensation And Steering – Subtitle A

A. Duty of Care – *Dodd-Frank §1402, adding new 15 USC §1639B(b)*

- Originators must be qualified and, if required by state law or SAFE Act, be registered and licensed;
- Must include the unique identifier (from SAFE Act) on all loan documents
- Subject to duties imposed by other applicable state and federal law.
- FRB/CFPB to promulgate rules requiring depository institutions to establish procedures to monitor compliance of this section and SAFE Act for its subsidiaries and employees.

B. Originator compensation (including yield-spread premiums) –

One major target of post-meltdown reforms was a common originator compensation model whereby lenders paid originators more for bringing in the riskier, more expensive loans. One of the theoretical underpinnings of the post-crisis reform was to re-orient market-incentives. In the case of originator compensation, the legislative result was simply to eliminate the perverse incentive to deliver unsustainable loans to the lender and onto the secondary market.

¹⁴ See 15 USC § 1602((f); Reg. Z, § 226.2(a)(17) for TIL definition of “creditor.”

¹⁵ Here, too, the FRB explains Dodd-Frank “creditor” exclusion from its originator compensation provisions to be consistent with its new rule, and explains the creditor exclusion (other than table-funded broker-creditors) to exclude “transactions that occur between creditors and secondary market purchasers, to which consumers are not a direct party....” See FRB Final rule to protect mortgage borrowers from unfair, deceptive and abusive loan originator compensation practices, Docket R-1366, supplemental information, p.35 (August 16, 2010), *available at* <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100816d1.pdf>; 75 Fed. Reg. at 58518.

The FRB was nearing the end of a three-year long process of evaluating originator compensation issues as Dodd-Frank was enacted. The Board decided to proceed with a final rule, released August 16, 2010, to avoid a long delay in bringing some measure of reform to the market.¹⁶ These new rules were issued pursuant to the Board's existing UDAP authority relating to mortgages under HOEPA, as well as its general rule-making authority under TIL.

This outline first looks at the Dodd-Frank provisions, then briefly compares them to the new FRB rules, which become effective with respect to applications received beginning April 1, 2011. See Table 2, below.

1. Dodd-Frank provisions regarding originator compensation incentives, including yield spread premiums, Dodd-Frank §1403, adding new 15 USC §1639B(c)

- Applies to “residential mortgage loans” (basically all closed-end residential mortgages, *see* II-B, above)
- Applies to both payors and payees -- no person can pay, and no originator can receive any direct or indirect compensation that varies with terms of loan, other than loan principal; *new §1639B(c)(1)*
 - The provision means that yield spread premiums or other compensation that would permit indirect and direct compensation to vary based on loan terms, other than principal, are subject to this ban, *new §1639B(c)(4)(A)*
- Dual source compensation prohibited, *i.e.* the originator cannot get compensation from both the consumer and any creditor or other third party who knows, or has reason to know of the consumer's direct payment to the originator. (Exception for *bona fide* third-party charges that neither creditor nor originator or affiliates thereof will retain.); *new §1639B(c)(2)(A)*;
- Allows for no-cost loans as exception, *new §1639B(c)(2)(B)*, provided
 - the originator gets no compensation directly from the consumer, *and*
 - the consumer does not pay any upfront discount or origination points, or fees, other than bona fide third party charges not retained by the creditor, originator, or an affiliate thereof. (The FRB/CFPB may waive this rule or provide exemptions if it is in the interest of consumers and the public).
- What the provision does **not** do –
 - Limit the amount for which a creditor can sell a consummated loan to a subsequent purchaser, *new §1639B(c)(4)(B)*; (*see also II-C-2 and note 14, above.*)
 - Restrict the consumer's ability to finance compensation, including through the rate or principal, that is otherwise permitted under this section, *new §1639B(c)(4)(c)*;
 - Prohibit volume-based compensation from the creditor to the originator, *new §1639B(c)(4)(d)*.

¹⁶ See note 2, above, FRB final mortgage origination rule, at Supp. Info., p. 4; 75 Fed. Reg. at 58509..

2. Remedies

- For originators other than creditors, remedies as allowable against creditors under 15 USC §1640 are available, subject to a maximum of the greater of actual damages or 3 times the total direct and indirect compensation, plus costs and attorneys fees, *Dodd-Frank § 1404, adding new §1639B(d)*.
- For creditors, §1640 damages, including enhanced damages under §1640(a)(4); *Dodd-Frank §1416, amending §1640(a)(4)*.
 - 3-year statute of limitations for these damages, *Dodd-Frank §1416, amending §1640(e)*
 - Defense to foreclosure against creditor, assignee or holder, or anyone acting on their behalf, by way of recoupment, irrespective of any time limit.
 - Maximum amount of recoupment damages capped at the amount that could have been received as an affirmative claim at expiration of 3-year statute of limitations.¹⁷
Dodd-Frank §1413, adding new §1640(k).

3. Comparison of Dodd-Frank originator compensation provisions to new Reg. Z §226.36(d), as amended 8/16/10, effective 4/1/2011

As noted above, the Board wished to avoid further delay, and so proceeded to release the HOEPA UDAP rules in final form, under its existing authority, though it will begin the process of harmonizing them with Dodd-Frank. The final rule was released August, 16, 2010, and is to become effective April 1, 2011. See 75 Fed. Reg. 58509 (Sept. 24, 2010), or <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100816d1.pdf>

A separate CRL outline summarizes the new FRB rule, but the table below compares the key provisions of Dodd-Frank and the current rule.

¹⁷ Enhanced damages under §1640(a)(4) includes “an amount equal to the sum of all finance charges and fees paid by the consumer, unless the creditor demonstrates that the failure to comply is not “material.” If a foreclosure occurred in year 8, a consumer could conceivably have paid 7 or 8 years’ worth of interest. The purpose of the cap is to stop the clock on that paid interest component of enhanced damages at the 3 year mark.

Table 2: Comparison of Dodd-Frank originator compensation and new FRB UDAP rule on originator compensation.

	Dodd-Frank §1403, adding new 15 USC §1639B(c)	Reg. Z, §226.36(d), as added 8/16/10, 75 Fed. Reg. 58509, 58534 (9/24/10).
Timeline	Latest possible date for rules to be issued, or effective date if no rules, 18 months after transfer date (January 21, 2013). ¹⁸	Effective April 1, 2011
Covered transactions	Closed-end mortgages secured by a dwelling; (time-shares excluded)	Same
Definition of “originator”	Any person who, for direct or indirect compensation or gain, or in the expectation thereof, takes a residential mortgage application, assists a consumer in obtaining or applying for such a loan, or offers or negotiates the terms of such a loan, including those who advertise themselves as such; Creditors in table-funded transactions covered, and individual loan officer-employees of creditors (see note 13). Otherwise, creditors excluded; as are servicers	A person who arranges, negotiates or otherwise obtains credit for another for compensation or other monetary gain, or in expectation thereof. Covers creditors in table-funded transactions, ¹⁹ and loan-originating employees of creditors that meet definition.
Applies to both “person” paying the compensation and originator receiving the compensation	yes	Yes
Nature of ban	Prohibits compensation based on terms of loan, other than principal	same; but further specifies that principal-based compensation must be a fixed percentage, though may be subject to maximum and minimum dollar amount
Dual-source compensation (i.e. combining direct payment from consumer with direct or indirect compensation from creditor or other person)	prohibited	Prohibited
Effect on increasing rate as means of paying upfront costs through the rate	Rate trade-off permitted in true no-cost loans, subject to ban on receiving payment from both consumer and creditor; must be	Subject to ban against receiving direct compensation from consumer and creditor, can pay some origination costs upfront

¹⁸ Dodd-Frank does not mandate rules implementing the originator compensation provision. If no implementing rules are issued, the provision would become effective January 21, 2013. But there unquestionably will be rules, and they will specify the effective date.

¹⁹ Exclusion is crafted as for creditors who fund the transaction at consummation out of their own resources, including a bona fide warehouse line of credit. Reg. Z, 226.36(a). Compensation paid to creditors for secondary market transactions are not covered. 75 Fed. Reg. at 58518.

	no <u>up-front costs</u> (other than bona fide third party charges not retained by creditor, originator or affiliate)	and some “back-end” through the rate
Remedy	<p><i>Non-creditor originators</i> – §1640 damages as available against creditor, but subject to cap of greater of actual damages or 3x total originator compensation plus costs & attorneys fees;</p> <p><i>Creditors</i> -- §1640 damages, including enhanced damages;</p> <p><i>Defense to foreclosure</i> – damages available by way of recoupment, including against assignees and holder ; amount of damages capped at amount available for affirmative claim (i.e. 3 years)</p>	<p>Regulatory enforcement</p> <p>Private enforcement under TIL unclear; possibly little, if any, available under current law.²⁰</p>

C. Steering

In part driven by the perverse incentives rewarding originators for making riskier, more expensive loans, originators (both brokers and retail originators) steered applicants who qualified for safer, prime loans in the wrong direction.

Dodd-Frank mandates that anti-steering rules aimed at specified practices be issued. *Dodd-Frank, §1403, adding new §1639B(c)(3).*

Steering is also addressed in the FRB’s August 16, 2010 final rule. The FRB rule is summarized in a separate outline, but a brief comparison of the two is included below in Table 3.

Note: All creditors are subject to this provision. The partial exclusion for creditors applicable to the compensation provision does not apply to the anti-steering subparagraph, §1639B(c)(3). *Dodd-Frank, §1401, adding new §1639(cc)(2)(F).*

1. Dodd-Frank provision on mandatory anti-steering rules –

Dodd-Frank requires the FRB/CFPB to issue rules that prohibit --

²⁰ As a practical matter, this question will have implications only between April 1, 2011 and the effective date of the Dodd-Frank provisions regarding these issues, including the remedies. Where violations of applicable law constitute unfair or deceptive practices under state law, state UDAP claims may be available.

- steering any consumer to a “residential mortgage loan”²¹ for which the consumer lacks a reasonable ability to pay (according to regulatory standards, *see* IV-A, below);
- steering to a loan that has predatory characteristics or effects (e.g. equity-stripping, excessive fees, or abusive terms);
- steering a credit-qualified consumer from a “qualified mortgage”²² to a non-qualified mortgage;
- engaging in abusive or unfair practices that promote disparities among equally credit-worthy consumers based on race, gender, ethnicity or age;
- mischaracterizing or suborning the mischaracterization of the applicant’s credit history, the loans available to the consumer, or the appraised value of the subject property;
 - *note:* mischaracterizing or suborning mischaracterization of an appraisal is repeated in the new appraisal provisions, *Dodd-Frank §1472, adding new TIL §1639E(b)(2)*. That is among the appraisal rules requiring early interim rule-making within 90 days from enactment, or by late October.
- discouraging a qualified consumer from looking elsewhere for a cheaper laon if the originator is not able to offer that product.

2. Remedies

- For originators other than creditors, remedies allowable against creditors under 15 USC §1640, subject to a maximum of the greater of actual damages or 3 times the total direct and indirect compensation, plus costs and attorneys fees, *Dodd-Frank § 1404, adding new §1639B(d)*.
- For creditors, actual and statutory damages under §1640 (enhanced damages under §1640(a)(4) are not available for steering violations.) (omitted from D-F §1416 amendment to §1640(a)(4));
- Defense to foreclosure by recoupment not available. (omitted from D-F §1413 addition of new §1640(k)).

3. Comparison of Dodd-Frank Anti-Steering and new FRB anti-steering rule, Reg. Z, §226.36(e).

The differences between the standards Dodd-Frank sets for the mandatory anti-steering rule and the new FRB anti-steering rule are pronounced. The FRB rule is narrower in substance, and includes a safe harbor based simply on what options are disclosed.

Table 3: Comparison of Dodd-Frank anti-steering and new FRB UDAP rule on steering.

	Dodd-Frank §1403, adding new 15 USC §1639B(c)(3)	FRB UDAP rule, Reg. Z §226.36(e) (August 26, 2010)
Timeline	Outside limit for final mandatory implementing rule, January 21, 2013 (18 months after transfer	Effective 4/1/2011

²¹ See II-B, above.

²² As defined by TIL, see II-A-1, above.

	date of July 21, 2011); outside limit for effective date, 12 months after final (outside limit, January 21, 2014) [<i>unlikely to take all that time.</i>]	
Covered transactions	Closed-end mortgages secured by a dwelling (time-shares excluded)	Same
Covered persons	Any person who, for direct or indirect compensation or gain, or in the expectation thereof, takes a residential mortgage application, assists a consumer in obtaining or applying for such a loan, or offers or negotiates the terms of such a loan, including those who advertise themselves as such. Note: There is no creditor exclusion to the anti-steering provision	A person who arranges, negotiates or otherwise obtains credit for another for compensation or other monetary gain, or in expectation thereof. Covers creditors in table-funded transactions, ²³ and loan originating employees of creditors, if the employee meets the general definition
Prohibited conduct	<i>Rule-making required to prohibit</i> > Steering any consumer to a “residential mortgage loan” ²⁴ for which the consumer lacks a reasonable ability to pay (according to regulatory standards, <i>see IV-A, below</i>) >has predatory characteristics or effects (e.g. equity-stripping, excessive fees, or abusive terms); >steering a credit-qualified consumer from a “qualified mortgage” ²⁵ to a non-qualified mortgage; >engaging in abusive or unfair practices that promote disparities among equally credit-worthy consumers based on race, gender, ethnicity or age; >mischaracterizing or suborning the mischaracterization of the applicant’s credit history, the loans available to the consumer, or the appraised value of the subject property; >discouraging a qualified consumer from looking	>Originator may not steer consumer to a transaction based on fact that originator would receive greater compensation than other products the originator offered or could have offered. >“Steering” means “advising, counseling or otherwise influencing a consumer to accept that transaction.” >The transaction must have been consummated. No steering if the consumer does not get a loan from that originator. OSC §226.36(e)(1)-1.

²³ Exclusion is crafted as for creditors who fund the transaction at consummation out of their own resources, including a bona fide warehouse line of credit. Reg. Z, 226.36(a). For creditor-employee originators, who will be barred from receiving compensation based on loan terms under compensation rule, compliance with that provision satisfies the anti-steering rule if the loan consummated is with the creditor. If the employee forwards the application to another creditor, he or she must comply as a broker. OSC §226.36(e)—2(ii).

²⁴ See II-B, above.

²⁵ As defined by TIL, see II-A-1, above.

	elsewhere for a cheaper loan if the originator is not able to offer that product.	
“Safe harbor”	None specified in statute	<ul style="list-style-type: none"> > originator must obtain loan options from “significant number” of creditors with which it regularly does business for each loan type in which consumer expresses interest; > options must include loans with lowest interest rate; lowest interest rate w/o riskier terms(as specified in rule); lowest dollar amount of origination costs; and > originator must have good faith belief the consumer likely qualifies for these options
Remedy	<p><i>Non-creditor originators</i> – §1640 damages as available against creditor, but subject to cap of greater of actual damages or 3x total originator compensation plus costs & attorneys fees;</p> <p><i>Creditors</i> -- §1640 actual & statutory damages, costs & attorneys fees</p> <p>(no enhanced damages, and no special foreclosure defense)</p>	<p>Regulatory enforcement –</p> <p>Private enforcement under TIL unclear²⁶</p>

IV. ORIGINATION STANDARDS – LOANS: Ability To Repay And Other Minimum Standards -- Subtitle B

Though the banking industry often opposed consumer protection reform efforts by arguing that they might jeopardize the safety and soundness of the financial institutions, the crisis demonstrated quite the opposite. Cavalier, drastic and widespread abandonment of underwriting standards clearly demonstrated that the absence of such protections contributed to a serious threat to safety and soundness. Consequently, reform efforts included common sense measures to restore safer, more sustainable lending norms to the mortgage market, for the benefit of the financial sector, and the economy as a whole, as well as homeowners and home-buyers.

²⁶ See note 20, above.

A. Ability to Repay (“ATR”) – Dodd-Frank §1411, adding new TIL, 15 USC §1639C

1. Standards – new §1639C(a)

- Applies to “residential mortgage loans” (basically all closed-end residential mortgages, *see* II-B, above)
- FRB/CFPB implementing regulations, orders and guidances cannot require underwriting standards for depositories (banks, thrifts and credit unions) that do not meet the minimum underwriting standards set by the federal banking regulators.²⁷
- Creditor must make 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, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance) and assessments.
- Standards for evaluation are detailed, including taking into account multiple loans (e.g. look at combined ATR for 80/20s); verify income; and prescribed bases for calculating ATR on non-standard loans.
 - Some exemptions from income verification permitted for government-insured streamlined refinancing in certain conditions.

2. Rebuttable Presumption – new §1639C(b)

Creditors and assignees who are subject to liability may presume compliance with the ability to repay requirement if it is a “qualified mortgage” as defined by TIL under Dodd-Frank. (*See* Section II-A and Table 1, above, for Dodd-Frank’s TIL definition of “qualified mortgage.”)

3. Remedies

- §1640 damages, including enhanced damages – *Dodd-Frank §1416, amending §1640(a)(4)*
- Defense to foreclosure against creditor, assignee or holder, or anyone acting on their behalf, by way of recoupment irrespective of any time limit.
 - Amount of recoupment in defense is the amount the consumer would have been entitled to if timely brought as an affirmative claim under §1640, including the enhanced damages. The amount is capped at the amount that could have been received at expiration of 3-year statute of limitations.²⁸ *Dodd-Frank §1413, adding new §1640(k).*

B. Prepayment penalties –Dodd-Frank §§1414 & 1431

²⁷ The statute uses the term “prudential regulators”, defined in Title X, the Consumer Financial Protection Act, as the applicable federal banking agency – FRB, OCC, FDIC and NCUA. (Dodd-Frank abolished the OTS.) Dodd-Frank §1002(24).

²⁸ Enhanced damages under §1640(a)(4) includes “an amount equal to the sum of all finance charges and fees paid by the consumer, unless the creditor demonstrates that the failure to comply is not material.” If a foreclosure occurred in year 8, a consumer could conceivably have paid 7 or 8 years’ worth of interest. The purpose of the cap is to stop the clock on that paid interest component of damages at the 3 year mark.

Prepayment penalties are targeted in the mortgage reform efforts because they impacted the mortgage market negatively in several ways: they were implicated in equity stripping; they locked borrowers into bad mortgages, making it too expensive to refinance into cheaper, less risky loans; and the industry’s preference for them led it to pay originators more for them, adding to borrower’s costs on both the front and back end. Not surprisingly, given these distortions, evidence also connects them to a higher risk of foreclosure.²⁹

The reform provisions take three forms:

- direct restrictions that allow prepayment penalties only on qualified mortgages that are also fixed-rate and non-subprime, and limit the amount and term;
- indirect restriction through including them in the definition of “fees and points.” The “fees and points” definition, which is used both for purposes of defining a “qualified mortgage” and in the revised HOEPA trigger, now includes prepayment penalties. *See VI-A, below, for an explanation of how and when they are to be counted.*)
- indirect restriction by tying a new, third independent alternative trigger tied to prepayment penalties only to the definition of a high cost mortgage. *See VI, below.*³⁰

To start with a bottom line summary: Prepayment penalties will be prohibited in *closed-end* loans (“residential mortgage loans”³¹), except for fixed rate “qualified mortgages” that are below a specified APR threshold. The HOEPA provisions will also act as indirect downward pressures on prepayment penalties on HELOCs, since the open-end exclusion from the “high-cost loan” definition has been repealed. When prepayment penalties are permitted on closed-end loans, an amount of up to 3% is allowed, but in practice, the amount is likely to be limited to 2%, (*see VI-A-4, below.*)

In those loans where they will be allowed, they cannot be imposed after 3 years, and are limited in amount to 3% for the first year,³² 2% for the second, and 1% for the third. The consumer must be offered an option of a loan product with no prepayment penalty.

. Table 4, below, summarizes all the relevant prepayment penalty provisions in Title XIV.

Table 4: Summary of Prepayment Penalty Reforms [“PPP” = prepayment penalty]

	Dodd-Frank	Current HOEPA / FRB rules
Definition of “fees & points” (for purposes of HOEPA trigger and	“fees and points” includes: > maximum amount of PPP that	PPP not included in fees and points definition

²⁹ Some of the evidence is discussed in Center for Responsible Lending, Comments on Proposed Rules Regarding Unfair, Deceptive, Abusive Lending and Servicing Practices, FRB Docket R-1305 (April 8, 2008), *available* on CRL’s website, www.responsiblelending.org.

³⁰ Consider this the 2 belts and suspenders approach to trying to address a problem. As is explained in Section VI, below, legislation to update HOEPA had been around for five years prior to the crisis, at least, and efforts were made to harmonize it with the later drafts as they developed. Some of it is not as neatly harmonized as others. But the message is clear and consistent – they should be fairly rare and small.

³¹ See II-B, above; “residential mortgage loans” excludes HELOCs and time shares.

³² But see VI-A-4, below, on a new independent high-cost loan prepayment penalty trigger.

“qualified mortgage”)	<i>could</i> be charged under terms of loan being made, <i>and</i> > prepayment penalties on refinance of previous loan made or currently held by same creditor or affiliate, <i>D-F Sec. 1431, amending 1602(aa)(4)(E)&(F) [HOEPA]; Sec. 1412, new 1639C(b)(2)(C)(i)</i> [“qualified mortgage”]	
High-cost mortgage definition independent alternative trigger	Mortgage secured by a principal dwelling (other than reverse mortgage) is a “high cost loan” if the loan either permits a prepayment penalty after 3 years, ³³ <i>or</i> it exceeds more than 2% of the amount prepaid. ³⁴ <i>D-F §1431, new §1602(aa)(1)(A)(iii).</i>	NA
“qualified mortgages” (TIL) – general rule	>3-2-1 permitted (3% in 1 st year; 2% in 2 ^d , 1% in 3 rd), with none more than 3 years long; and > consumer must be offered option of a loan with no prepayment penalty <i>D-F Sec. 1414, new 1639C(c)(3)</i>	NA
Certain “qualified mortgages” subject to prepayment penalty ban	Prohibited in “qualified mortgages” that are > adjustable rate, or > have APRs exceeding 1.5% over a designated index rate for first liens (2.5% for jumbo); and 3.5 or subordinate. <i>D-F Sec. 1414, new 1639C(c)(1)(B)</i>	NA
“Non-qualified,” non-HOEPA closed-end residential mortgages	Prohibited, <i>D-F Sec. 1414, new 1639C(c)(1)</i>	NA
“Higher cost” mortgages	<i>Term not used in D-F, but see above – “qualified mortgages subject to ppp ban”</i>	(as defined by Reg. Z, §226.35(a)) ³⁵ – <i>Permitted</i> , if otherwise authorized by law, as follows: > 2 year maximum, > rate is fixed for at least 4 years, and > the penalty will not apply to same creditor or affiliate refi. <i>Reg. Z, §226.35(b)(2).</i>
HOEPA	Prohibited, <i>D-F, Sec. 1432,</i>	<i>Permitted</i> , if otherwise authorized

³³ Since there is a 3-year limit on prepayment penalties where there are permitted at all, this prong of the trigger may get rusty from non-use.

³⁴ While 3% penalties in the first year are permitted for certain qualified mortgages, this provision is likely to discourage them.

³⁵ The APR threshold is similar to the APR-triggered ban in Dodd-Frank for otherwise qualified mortgages. The current FRB “higher-cost” APR threshold is 1.5% over average prime offer rate for comparable terms for first liens, and 3.5% for subordinate.

(note: HELOCs are now subject to HOEPA, see VI-A-1, below)	<i>repealing current 1639(c)(2)</i>	by law, as follows: > 2 year maximum, > at consummation, consumers verified DTI does not exceed 50%; > rate is fixed for at least 4 years; and > penalty will not apply to same-creditor or affiliate refinance., <i>Reg. Z, §226.32(d)(7).</i>
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C. Other Provisions – Dodd-Frank §1414

- *Credit insurance financing ban* --Financing single-premium credit insurance is banned in closed- and open-end mortgage loans secured by a principal dwelling, (monthly premiums permitted; credit unemployment permitted if reasonable premiums, no compensation to creditor or affiliate) -- *adding new §1639C(d).*
- *Binding mandatory pre-dispute arbitration banned* – applies to closed- and open-end mortgage loans secured by principal dwelling, and no waiver of claims permitted, *adding new §1639C(e)*
- *Negative amortization* – special warning disclosures required, and first- time borrowers must provide documentation of counseling from HUD-certified counselors. Applies to closed- and open-end mortgages, not limited to principal dwelling; excludes reverse mortgages, *adding new §1639C(f)*
- *Notice of potential loss of anti-deficiency protection* – notice of anti-deficiency protections and their importance required; if refinancing applied for that would result in loss of such protection, notice of that required, *adding new §1639C(g)*
- *Notice of policy regarding partial payments* – notice of policies about accepting partial payments, and, if accepted, how they will be applied, is required, *adding new §1639C(h)*
- *Time shares* –excluded from all §1639C provisions.

E. Additional Disclosure Requirements

- *Hybrid ARMs* – 6 month advance notice of first reset, including good faith estimate of monthly payment after reset and list of alternatives; applies to hybrid ARMs on principal dwellings, *Dodd-Frank §1418, adding new 1638A.*
- *Additional initial disclosures*– for ARMs, initial PITI and fully indexed PITI; for closed-end residential loans, aggregate settlement costs, aggregate originator fees, total interest over life of loan as percentage of loan principal, *Dodd-Frank §1419, adding new §1638(a)(16)-(19)*
- *Periodic statements required for closed-end mortgage loans* – including principal loan amount; current interest rate in effect, date of next reset, amount of any prepayment penalty, description of late fee, contact information, information about

counseling agency, and other information as required by rule; not required if coupon book provided, *Dodd-Frank §1420, adding new §1638(f)*.

V. AMENDMENTS TO TIL REMEDIES -- General – *Dodd-Frank §1416*

A. Monetary damages – *amending §1640(a)*

- Minimum statutory damages raised to \$200 and maximum raised to \$2000, for non-mortgage loans and leases³⁶
- Class action cap at lesser of 1% of net worth or \$1 million (up from \$500,000).

B. Statute of limitations, *amending §1640(e)*

- 3 year statute of limitations for violations of §§1639, 1639B, and 1639C

C. Additional creditor defense, *adding new §1640(l)*³⁷

- No creditor or assignee liable for damages or rescission if the obligor or any co-obligor “has been convicted of obtaining by actual fraud such residential mortgage loan.”

D. Additional state Attorney General Enforcement Authority – *Dodd-Frank §1422, amending §1640(e)*

- State AGs given authority to enforce HOEPA, the new provisions §§1639B and §1639C (originator standards including duty of care, compensation, anti-steering, ability to pay and other origination provisions described above.)
- State AGs also given authority to enforce new Dodd-Frank provisions not discussed in this outline, new §§1639D-H, covering various servicing and appraisal reforms, *Dodd-Frank Title XIV, subtitles E, F*

VI. HOEPA AMENDMENTS – *Dodd-Frank Subtitle C, amending the Homeownership and Equity Protection Act of 1994 (regarding high-cost mortgages)*³⁸

Legislative amendments to close loopholes in and otherwise modernize the 1994 Home Ownership and Equity Protection Act began in earnest in approximately 2005, while the bubble was still expanding.³⁹ These efforts had not made much headway, until the crisis. Most of the debate in Dodd-Frank mortgage reform centered on the larger mortgage market, but Title XIV incorporated these longer-standing proposals as Subtitle C, refining

³⁶ Reading the statute would lead one to believe that this minimum/maximum applies only to Consumer Lease Act violations. However, that result was likely the result of drafting confusion in 1995 amendments, and the Supreme Court decision in *Koons Buick Pontiac, Inc. vs. Nigh*, 543 U.S. 50 (2004) means the maximum is likely to be applied to all non-mortgage credit. *See NCLC Truth in Lending §8.6.2.2.*

³⁷ Dodd-Frank also creates a separate right-to-cure for high-cost loan HOEPA violations, *see VI-C, below.*

³⁸ This outlines only the significant changes in Dodd-Frank to the high-cost mortgage provisions. For a general explanation of HOEPA, including existing requirements, *see NCLC Truth in Lending Chapter 9.*

³⁹ *Compare, e.g. HF1182 (110th Congress)*

them to further take lessons of the crisis into account and to harmonize with the larger-market reforms in the bill.

A. Key changes to HOEPA's high-cost mortgage definition --

1. Base definition of a high-cost mortgage –

Any consumer loan secured by the consumer's principal dwelling (except reverse mortgages), if it meets any one of three independent triggers: *either* a) the “fees and points” trigger *or* b) the “APR” trigger *or* c) a new prepayment penalty trigger. (Closed end, open-end and purchase money consumer loans secured by principal dwelling are now covered. Dodd-Frank §1431, amending §1602(aa)(1)(A).⁴⁰)

2 Fees and points trigger

a. Fees and points trigger amount

- Total fees and points “payable in connection with the transaction”,⁴¹ not including bona fide third party charges not retained by the originator, creditor, or affiliate of either:
 - **5%** or less for loans \$20,000 or over
 - lesser of 8% or \$1000 for loans under \$20,000; FRB/CFPB may adjust dollar amount, Dodd-Frank §1431, amended §1602(aa)(1)(A)(ii).
- Adds rule for calculating the amount of total fees and points in HELOCs.

b. Fees and points definition additions & changes – Dodd-Frank §1431(a), (c), amending §1602(aa)(4)

- Special rules for mortgage insurance – *amended §1602(aa)(1)(C)*:
 - **excludes** premiums provided by federal or state government agencies;
 - **excludes** any premium paid after closing ;
 - **excludes** private, upfront MPI, if not in excess of National Housing Act premiums, is refundable on pro-rata basis and automatically issued on satisfaction of obligation.
- Specifies that mortgage brokers' compensation **includes yield spread premiums** (all compensation to mortgage originator includes direct and indirect compensation paid by either consumer or creditor from any

⁴⁰ Existing HOEPA excludes purchase money mortgages (“residential mortgage transactions”) and open-end mortgage loans. These exclusions were dropped from the baseline definition.

⁴¹ Existing HOEPA refers to fees and points “payable by the consumer at or before closing.” That language served as the statutory basis for some of the arguments that yield spread premium payments to originators were not captured by the fees and points definition despite the fact that “all compensation paid to mortgage brokers” was specifically listed. *See generally* NCLC *Truth in Lending* § 9.2.6.3.4

source), and *includes payments to the broker/creditor in a table-funded transaction*;

- Adds **maximum prepayment penalties payable** on the transaction at issue;
- Adds **prepayment penalties incurred** if the loan refinances a prior loan made by or currently held by same creditor or affiliate;
- Codifies the Board's previous addition of single-premium credit insurance;
- Excludes *bona fide* discount points in prescribed amounts and conditions, *new §1602(dd)*.

3. APR Trigger

- 6.5% over average prime offer rate (defined) for first liens
- 8.5% over for subordinate liens, and for first liens on personal-property dwelling under \$50,000
- Calculation for ARMs takes maximum rates into account
 - if rate varies solely with index, then consummation-date index plus maximum margin; any other kind of ARM, then maximum rate that can be charged
- FRB/CFPB has authority to adjust rate 6.5% threshold on firsts down to 6% and up to 10% for subordinates; down to 8% and up to 12% for subordinates.

4. Prepayment penalty trigger (new)⁴²

The new “high-cost mortgage” definition includes a third independent, alternative trigger keyed solely to prepayment penalties. If the loan documents permit either of the following with respect to prepayment penalties, a consumer loan secured by a principal residence is a “high-cost mortgage:”

- a prepayment penalty after 36 months, *or*
- prepayment penalties that, in the aggregate, exceed more than 2% of the amount prepaid.

As noted earlier, elsewhere, Dodd-Frank banned prepayment penalties longer than 3 years when they are permitted at all in closed-end mortgages, so the first prong is a belt-and-suspenders approach to assuring that consumers are not exposed to long-term prepayment penalties. Three percent prepayment penalties are permitted for first-year refinances in certain “qualified mortgages” (*see* section IV-C, above), but any loan that does so becomes a “high-cost mortgage”...in which prepayment penalties will now be banned. All of which should discourage prepayment penalties of more than 2%, even where allowed.

⁴² See notes 29-31 and accompanying text, and Table 4, to put this provision in context of Dodd-Frank and the evolution of this subtitle.

B. Changes and additions to substantive protections for high-cost loans – *Dodd-Frank §§1432, 1433, amending §1639*

- **Ban on financing points and fees,**
- Ban on financing prepayment penalty due in same-creditor refi
- Ban on prepayment penalties and balloon loans
- Pre-loan counseling required
- Other provisions regarding recommending default, late fee limitations, limiting right of acceleration.
- Ban on trying to evade by way loan structured
- No deferral or modification fees permitted
- Restrictions on pay-off statement fees, and statement must be provided within 5 business days

C. Changes to remedies for high-cost loan violations – *Dodd-Frank §1433, adding new §1639(v)*

- New right to cure provision for creditor or assignee: if violation was in good faith, no liability if creditor or assignee either cured within 30 days of closing, or 60 days of creditor's discovery or receipt of notice, and prior to institution of any action. Cure means to make appropriate restitution and make adjustments necessary to either bring the loan into compliance, or change the loan terms in a beneficial manner so that it is no longer a high-cost loan (consumer's choice).