

# HAWKINS ADVISORY

## CERTAIN REQUIREMENTS IMPOSED BY THE DODD-FRANK FINANCIAL OVERHAUL LEGISLATION REGARDING MORTGAGE ORIGINATIONS

In response to the concern with subprime mortgage lending and the perception that enhanced standards for origination of residential mortgage loans require federal regulation, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Legislation"), signed into law on July 21, 2010, includes Title XIV entitled the "Mortgage Reform and Anti-Predatory Lending Act." These standards, binding virtually all mortgage originators in the United States, are characterized as "federal consumer laws" (and covered by at least eighteen existing federal consumer protection laws such as the Truth in Lending Act, the Home Owners Protection Act of 1998, and the Real Estate Settlement Procedures Act). The new rules will fall under the jurisdiction of the Bureau of Consumer Financial Protection (the "Bureau") newly-created within the Federal Reserve System under Title X of the Legislation. They apply to "residential mortgage loans" which are consumer credit transactions secured by a mortgage or other security interest in real property that contains a dwelling (Section 1401). Specific and detailed exceptions to jurisdiction of the Bureau are contained in Title X that include certain real estate brokerage activities, manufactured home retailers, auto dealers, accountants and lawyers, regulated insurance companies, and employee benefit plans. Under Subtitle D of Title X, detailed provisions set out the extent of preemption of state laws (including state consumer protection laws and state securities laws) under the principle that the Legislation is not to be construed to exempt any person from complying with applicable state law, except to the extent such state law is inconsistent with the provisions of the Legislation. These provisions of the Legislation are detailed and in most instances require the issuance of regulations. The following is not intended to be a comprehensive outline of those provisions but, rather, an outline reflecting the breadth of the reach of these new federal mortgage origination requirements.

1. Any item in the Legislation as to which regulations have not been formulated is effective 18 months after the transfer to the Bureau of jurisdiction over certain previously-existing federal consumer protection laws and rules. Any item with promulgated regulations is effective 12 months after the date of the final regulations.
2. The Legislation applies to "mortgage originators" which means any "person" (without specific exclusion for state and local governmental entities or their agents) that, for direct or indirect compensation or gain, takes a mortgage loan application, or assists a consumer in obtaining a mortgage loan, or offers or negotiates terms of a mortgage loan (Section 1401). The term "mortgage originators" includes mortgage brokers, but excludes realtors unless they are employed by a mortgage originator, and excludes mortgage servicers including those assisting in replacing mortgage loan debt that is delinquent or in default. The term includes anyone who prepares mortgage loan packages, or collects information on behalf of consumers with regard to mortgage loans, or advertises that such person will provide origination assistance services for residential mortgage loans.
3. The Truth in Lending Act is supplemented to include specific provisions designed to assure that loans are given to consumers "on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive" (Section 1402).
4. Mortgage originators must comply with the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 and any registration requirements thereunder with the Nationwide Mortgage Licensing System and Registry (Section 1402).

5. Mortgage originators may not receive compensation that varies based on the terms of the loan (other than its principal amount). Only the consumer may compensate a mortgage originator with an origination fee or charge, provided, that a third party can so compensate the mortgage originator if the consumer has not paid any such origination fee or any points or other fees that are tantamount to an origination fee (Section 1403).
6. Regulations will establish rules to prevent mortgage originators from steering consumers to any mortgage loan that (a) is not affordable to the consumer, (b) is predatory (e.g., excessive fees, abusive terms), (c) is characterized under the Legislation as “not a qualified mortgage” when the consumer already had secured a “qualified mortgage”, (d) represents discriminatory lending (based on race, ethnicity, gender, age), (e) is based on a misrepresentation as to the consumer’s credit history or the appraised value of the residence, or (f) is more expensive than a loan for which the consumer qualifies when competitors offer such an affordable loan and the originator discourages reaching out to its competitors (Section 1403).
7. Consumers can sue under the Truth in Lending Act for violations of this Legislation and receive the greater of actual damages or 3 times direct and indirect gain accruing to the mortgage originator, plus costs and attorney fees. Any awards to consumers under this provision can also be used to offset foreclosure proceeds sought by lenders. (Sections 1404 and 1413)
8. Sections 1411- 1414--The Legislation sets out certain minimum standards for mortgages. Among those standards are: *Ability to repay*—the originator must obtain appropriate information concerning the consumer’s ability to repay the loan, including income verification (tax returns, payroll receipts, etc.), although refinancing of non-delinquent loans is exempt if the principal or interest rate is not increased (or the rate is converted from variable to fixed). Any assignee can assume that a “qualified mortgage” evi-

dences appropriate “ability to repay”. A “qualified mortgage” is one where principal installments do not increase and are not deferred (negative amortization), which does not have a balloon payment that is twice the size as the average monthly payment (unless Board regulations set other standards for balloon payment loans), that has documentation of income verification requirements, that (if a variable rate loan) is underwritten based on the highest rate during the first 5 years, that meets Board guidelines for borrower debt-to-loan ratios, that has fees and points not exceeding 3 percent of loan amount, and that has a term not exceeding 30 years (except for loans in “high cost areas”)—all subject to exceptions stated in Board regulations upon a finding that such regulations are necessary to ensure the availability of affordable mortgage credit. *Prepayment penalties*—only a “qualified mortgage” may have prepayment penalties, and only if the mortgage also has an interest rate that does not exceed allowed percentage points (from 1.5 for first liens to 3.5 for subordinate liens) over the “average prime offer rate” to be published by the Board. Prepayment penalties cannot exceed 3% of loan balance in the first year, scaling down each year to zero after 3 years has expired. *Notice of rate reset*—for loans that have initial fixed rates that convert to variable, the borrower must receive detailed notice of the rate reset at least 6 months prior to the date of reset. *High cost mortgages*—examples of “high cost mortgages” are first mortgages with rates at least 6.5 percentage points over the average prime offer rate, or that have points and fees exceeding 5 percent of the total transaction amount, or that have prepayment penalties more than 2 percent following 3 years after origination. High cost mortgages may not charge late fees, unless loan documents are specific about it, in excess of 4 percent of the past due amount. High cost mortgages cannot be originated unless the consumer has been approved by a housing counselor (including a State HFA) approved by HUD.

9. The new Office of Housing Counseling is established to provide a system of counseling to borrowers and also to renters in multifamily

housing. Computer software programs that assist borrowers in understanding mortgage loan proposals will be certified by HUD. HUD will make grants available to counseling agencies (which are to include State HFAs). HUD financial assistance programs will be conditioned on participation in housing counseling. (Sections 1441-1445)

10. Special rules will be issued regarding required escrows and rights of consumers to waive establishment of escrows. (Section 1461)
11. Servicers of federally related mortgages may not impose “forced” hazard insurance requirements without full investigation and disclosure of coverage obtained by the borrower. (Section 1463)
12. Rules regarding appraisers and appraisal management companies will be set out in regulations. (Sections 1431 and 1471)
13. With respect to multifamily rental properties, regulations are required to be promulgated with the intention of ensuring the protection of current and future tenants and at-risk multifamily

properties. These are to include revisions to the Home Affordable Modification Program of the Making Home Affordable initiative of the U.S. Treasury. (Sections 1481, 1482)

If there are any questions regarding the matters covered by this summary, please reach out to any member of the Housing Group at Hawkins Delafield & Wood LLP.

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