

CFPB ISSUES NEW RULES FOR HIGH-COST MORTGAGES AND HOMEOWNERSHIP COUNSELING

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I. Scope and Overview

On January 10, 2013, the Consumer Financial Protection Bureau (the “Bureau”) issued a final rule (the “Rule”) that amends Regulation Z (Truth in Lending) to implement changes to the Home Ownership and Equity Protection Act (“HOEPA”) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or “Dodd-Frank”). The Rule expands the types of loans subject to HOEPA, revises the tests for whether a loan is “high-cost” and therefore subject to HOEPA, imposes new restrictions on high-cost loans, and requires new disclosures.

Loans that meet HOEPA’s high-cost coverage tests are currently subject to special disclosure requirements and restrictions on loan terms.¹ Borrowers in high-cost mortgages² also have enhanced remedies for violations of the law.³ Purchasers and assignees of high cost mortgages, unlike acquirors of non-HOEPA loans, are subject to all claims and defenses that may be brought against the original creditor with respect to the mortgage, with certain limited exceptions.⁴ For these reasons, very few HOEPA loans are originated in today’s market. In fact, according to the Bureau:

[B]etween 2004 and 2011, high-cost mortgages typically comprised about 0.2 percent of HMDA-reporters’ originations of refinance or home improvement loans secured by a one-to-four family home (the class of mortgages generally covered by HOEPA). . . This percentage fell to 0.05 percent by 2011 when nearly 2,400 high-cost mortgages were

¹ See generally 12 C.F.R. § 1026.32.

² Mortgages covered by the HOEPA amendments have been referred to as “HOEPA loans,” “Section 32 loans,” or “high-cost mortgages.” The Dodd-Frank Act now refers to these loans as “high-cost mortgages.” The Bureau notes that for simplicity and consistency, the Rule uses the term “high-cost mortgages” to refer to mortgages covered by the HOEPA amendments.

³ See, e.g., 15 U.S.C. § 1640(a)(4).

⁴ An assignee will not be liable if it can demonstrate that a reasonable person exercising ordinary due diligence, could not determine, based on the specified disclosures that the mortgage was a high cost mortgage. 15 U.S.C. §1641(d).

reported compared with roughly 4.5 million refinance or home-improvement loans secured by a one-to-four family home.⁵

Based on these statistics, the HOEPA threshold has acted as a *de facto* usury ceiling for the vast majority of mortgage originators. With the Rule's extension of HOEPA to more types of loans, and the lowering of the HOEPA thresholds, this ceiling will now affect a broader segment of consumers seeking mortgage loans than before.

The Rule also implements two additional Dodd-Frank provisions that are not amendments to HOEPA related to homeownership counseling. The first requires that first-time borrowers receive homeownership counseling before taking out a negative amortization loan. The second is an amendment to RESPA that requires the disclosure of a list of counseling organizations to any consumer applying for a federally related mortgage loan within three business days after receiving the consumer's application.

The Rule is effective January 10, 2014.

II. Expansion of HOEPA's Coverage

A. Inclusion of New Loan Types

The Rule expands the types of loans that may be subject to HOEPA by removing the previous exclusions for "residential mortgage transactions" (defined under Regulation Z to mean purchase money mortgage loans) and home equity lines of credit ("HELOCs") as potentially covered loans.⁶ Thus, the term high-cost mortgage now may include both a closed-end credit transaction and an open-end credit plan secured by the consumer's principal dwelling. For purposes of determining coverage under 12 C.F.R. § 1026.32, the Commentary⁷ to the Rule clarifies that an open-end consumer credit transaction is the account opening of an open-end credit plan. An advance of funds or a draw on the credit line under an open-end credit plan subsequent to account opening does not constitute an open-end "transaction."⁸

The Rule retains the exemption for reverse mortgages, largely because they are already subject to counseling requirements, and also exempts three other types of loans – construction loans, loans originated and financed by Housing Finance Agencies,⁹ and loans originated through the United States Department of Agriculture's (USDA) Rural Housing Service section

⁵ Bureau of Consumer Financial Protection, Final Rule, High-Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X) (Jan. 10, 2013), http://files.consumerfinance.gov/f/201301_cfpb_final-rule_high-cost-mortgages.pdf (publication in the Federal Register forthcoming) [hereinafter "*High-Cost Final Release*"] at 349.

⁶ 12 C.F.R. § 1026.32.

⁷ This Alert uses shortened citations to refer to the official Commentary following each rule. For example, the shortened citation "Cmt. 1026.32" refers to the Commentary to 12 C.F.R. § 1026.32. Additionally, when citing regulations, the Alert occasionally omits "12 C.F.R." and simply cites the section number for ease of reading.

⁸ Cmt. 1026.32(a)(1) - 1.

⁹ A Housing Finance Agency means a housing finance agency as defined in 24 C.F.R. § 266.5.

502 Direct Loan Program – all of which the Bureau believes do not present the same risk of abuse as other mortgage loans.

B. Lower Triggers for High-Cost Mortgages

The Rule expands HOEPA’s reach by revising the tests for whether a loan is considered a high-cost mortgage. The annual percentage rate (“APR”) and “points and fees” triggers are lower and a new prepayment penalty trigger has been added. Meeting any one of the three tests makes a loan a high cost mortgage.

A “high-cost” mortgage is now defined as a consumer credit transaction secured by the consumer’s principal dwelling in which:

1. APR Test

The APR applicable to the transaction will exceed the “average prime offer rate” (as defined in 12 C.F.R. § 1026.35(a)(2)), for a comparable transaction by more than:

- 6.5 percentage points for a first-lien transaction, other than as described in the second bullet below;
- 8.5 percentage points for a first-lien transaction if the dwelling is personal property and the loan amount is less than \$50,000 (this is intended to apply, among other things, to loans secured by manufactured homes that constitute personal property) ; or
- 8.5 percentage points for a subordinate-lien transaction; or

2. Points and Fees Test

The transaction’s total “points and fees” will exceed:

- 5 percent of the total loan amount for a transaction with a loan amount of \$20,000 or more (the \$20,000 figure is adjusted annually for inflation); or
- The lesser of 8 percent of the total loan amount or \$1,000 for a transaction with a loan amount of less than \$20,000 (the \$1,000 and \$20,000 figures are adjusted annually for inflation); or

3. Prepayment Penalty Test

Under the terms of the loan contract or open-end credit agreement, the creditor can charge a prepayment penalty¹⁰ more than 36 months after consummation or account opening, or prepayment penalties that can exceed, in total, more than 2 percent of the amount prepaid.

¹⁰ A “prepayment penalty” under the Rule generally will include — in addition to more obvious examples — an origination or other closing cost fee that is waived by the creditor on the condition that the consumer does not prepay the loan. Cmt. 1026.32(b)(6)-1.ii. However, such a waived charge will not be considered a “prepayment

C. Interest Rate Used to Determine Annual Percentage Rate

The Dodd-Frank Act added section 103(bb)(1)(B) to the Truth in Lending Act (“TILA”) to instruct creditors to use one of three methods to determine the interest rate for purposes of calculating the APR for high-cost mortgage coverage. This guidance allows creditors to determine whether a loan will constitute a HOEPA loan on the date the interest rate is set. The Rule implements this provision as follows:

- For a transaction in which the APR will not vary during the term of the loan or credit plan, the interest rate in effect as of the date the interest rate for the transaction is set
- For a transaction in which the interest rate may vary during the term of the loan or credit plan in accordance with an index, the interest rate that results from adding the maximum margin permitted at any time during the term of the loan or credit plan to the value of the index rate in effect as of the date the interest rate for the transaction is set, or the introductory interest rate, whichever is greater; and
- For a transaction in which the interest rate may or will vary during the term of the loan or credit plan, other than a transaction described in the previous paragraph, the maximum interest rate that may be imposed during the term of the loan or credit plan.¹¹

The Bureau acknowledged that the APR for closed-end mortgage loans includes non-interest components, while the APR for HELOCs does not, but declined to make any changes to the Rule to account for this difference.

D. Impact of More Inclusive Finance Charge

The Bureau’s 2012 TILA-RESPA Proposal sought comment on whether to adopt a more inclusive finance charge proposal, under which the finance charge would include several real estate related fees that are currently excluded from the finance charge calculation.¹² A more inclusive finance charge would by necessity increase the APR and points and fees on many loans and result, among other things, in more loans meeting the HOEPA APR and points and fees triggers. The Bureau proposed alternative approaches to address this issue, including the use of a “transaction coverage rate” and other metrics. This issue is not addressed in the Rule because the Bureau has decided to defer a decision whether to adopt the more inclusive finance charge proposal and any related adjustments to regulatory thresholds until it later finalizes the TILA-RESPA Proposal.

penalty” to the extent it is bona fide if (i) it is a third-party charge and (ii) the waiver applies only to prepayments of “all of the transaction’s principal sooner than 36 months after consummation.” 12 C.F.R. § 1026.32(b)(6).

“Prepayment penalties” also do not include fees imposed for preparing and providing documents when a loan is paid in full — such as a payoff statement or a reconveyance document — so long as such fees are imposed whether or not the loan is prepaid. Cmt. 1026.32(b)(6)-2.i.

¹¹ 12 C.F.R. § 1026.32(a)(3).

¹² 77 Fed. Reg. 51116, 51125 (Aug. 23, 2012).

E. Determination of APOR for Comparable Transactions

The new Commentary to the Rule (“Commentary”) notes that guidance for determining the APOR for a comparable transaction is set forth in the existing Regulation Z Commentary to 12 C.F.R. § 1026.35(a), which governs higher-priced mortgage loans.¹³ This guidance directs creditors to published tables of average prime offer rates for fixed- and variable-rate closed-end credit transactions. Because there are no similar tables for open-end credit, creditors opening HELOCs must compare the APR for the HELOC plan to the average prime offer rate for the most closely comparable closed-end transaction.

To identify this most closely comparable closed-end transaction, the creditor must focus on (1) whether the credit plan is fixed- or variable-rate; (2) if the plan is fixed-rate, the term of the plan to maturity; (3) if the plan is variable-rate, the duration of any initial, fixed-rate period; and (4) the date the interest rate for the plan is set. The Commentary further provides:

If a fixed-rate plan has no definite plan length, a creditor must use the average prime offer rate for a 30-year fixed-rate loan. If a variable-rate plan has an optional, fixed-rate feature, a creditor must use the rate table for variable-rate transactions. If a variable-rate plan has an initial, fixed-rate period that is not in whole years, a creditor must identify the most closely-comparable transaction by using the number of whole years closest to the actual fixed-rate period. For example, if a variable-rate plan has an initial fixed-rate period of 20 months, a creditor must use the average prime offer rate for a two-year adjustable-rate loan. If a variable-rate plan has no initial fixed-rate period, or if it has an initial fixed-rate period of less than one year, a creditor must use the average prime offer rate for a one-year adjustable-rate loan. Thus, for example, if the initial fixed-rate period is six months, a creditor must use the average prime offer rate for a one-year adjustable-rate loan.¹⁴

F. Definition of Points and Fees for Closed-End Transactions

With only minor exceptions, the definition of “points and fees” for HOEPA purposes tracks the new definition of the term for purposes of the Qualified Mortgage safe harbor under the Bureau’s Ability-to-Repay final rule.

The points and fees definition presents a threshold issue of timing. Specifically, the opening clauses of the definition provide that “*points and fees* means the following fees or charges *that are known at or before consummation.*”¹⁵ The Commentary explains that in general, a charge is “known” in this sense if “the creditor *knows at or before consummation that the charge or fee will be imposed in connection with the transaction, even if the charge or fee is scheduled to be paid after consummation.*”¹⁶ Thus, a charge to the customer that is known by consummation is includable in “points and fees” “even if the consumer finances it and repays it over the loan term.”¹⁷ As is explained below, however, this general guidance in the Commentary

¹³ Cmt. 1026.32(a)(1)(i) – 2.

¹⁴ *Id.*

¹⁵ 12 C.F.R. § 1026.32(b)(1) (second emphasis added).

¹⁶ Cmt. 1026.32(b)(1)-1.i (emphasis added).

¹⁷ Cmt. 1026.32(b)(1)-1.i.

is at times over-ridden by specific directions in the Rule about whether particular charges are in or out of the definition.

1. Non-Interest Components of the Finance Charge

a. The General Rule

Subject to the five important exceptions described below, “points and fees” includes all non-interest components of the finance charge.

b. Exceptions to Including Non-Interest Components of the Finance Charge

(1) Government Mortgage Insurance or Guarantee Fees

“Points and fees” does not include government mortgage insurance or guarantee fees, *i.e.*, Federal Housing Administration (“FHA”) mortgage insurance premiums or guarantee fees for Department of Veterans Affairs (“VA”) or Rural Housing Service (“RHS”) loans. This rule applies whether the fees are payable before, at, or after consummation. Thus, both up-front fees and post-consummation periodic payments are excluded.¹⁸

(2) All PMI Fees Payable After Closing

“Points and fees” also does not include private mortgage insurance (“PMI”) premiums or other charges that are “payable after consummation.”¹⁹ This is so “even if the amounts of such premiums and charges are known at or before consummation.”²⁰

(3) At Least a Portion of Certain Up-front PMI Fees

At least a portion of PMI premiums or charges “payable at or before consummation” — so-called “up-front” premiums — are excluded from “points and fees” where the premium is refundable on a pro rata basis and the refund is automatically issued upon notification that the loan is paid in full.²¹ If that “refundability” condition is satisfied, then a creditor may exclude from “points and fees” the portion of the up-front premium that does not exceed the amount that the borrower would pay for FHA insurance on the transaction. A creditor should make the comparison to the FHA amount “even if the transaction would not qualify to be insured [by the FHA] (including, for example, because the principal amount exceeds the maximum insurable under [FHA policies]).”²² Any portion of the up-front PMI premium that is above the FHA amount will be included in “points and fees,” whether it satisfies the refundability condition or not. The Commentary provides a numerical example to explain this rule on up-front PMI premiums.²³

¹⁸ 12 C.F.R. § 1026.32(b)(1)(i)(B).

¹⁹ 12 C.F.R. § 1026.32(b)(1)(i)(C)(I).

²⁰ Cmt. 1026.32(b)(1)-1.iii.

²¹ 12 C.F.R. § 1026.32(b)(1)(i)(C)(2).

²² Cmt. 1026.32(b)(1)(C)-1.ii(A).

²³ Cmt. 1026.32(b)(1)(C)-1.ii(C).

The Commentary emphasizes that this provision refers to PMI premiums that are “payable” at or before consummation, regardless of whether they are actually paid in cash at that time or financed.²⁴

(4) Unretained Third Party Charges Not Expressly Included as Points and Fees by Other Provisions of the Rule

The Rule excludes from “points and fees” “[a]ny bona fide third-party charge not retained by the creditor, loan originator, or an affiliate of either,” but then carves out exceptions to the exclusion that limit its practical impact.²⁵ Specifically, the following charges are exceptions to this exclusion, *i.e.*, the following count as points and fees regardless of whether or not they are “retained by the creditor, loan originator, or an affiliate of either”:

- as discussed above, PMI premiums “payable at or before consummation” that either exceed the FHA premium level or are not required to be automatically refunded on a pro-rata basis when the loan is paid in full;
- real estate charges that are not “reasonable,” as discussed below in connection with § 1026.32(b)(1)(iii); and
- premiums for credit insurance and debt cancellation or suspension coverage that are “payable at or before consummation,” as discussed below in connection with § 1026.32(b)(1)(iv).

An “affiliate” is “any company that controls, is controlled by, or is under common control with another company, as set forth in the Bank Holding Company Act of 1956.”²⁶ Under this Act, one company “controls” another if it (a) directly or indirectly owns 25% or more of any class of voting securities of the other company, (b) controls in any way the election of a majority of the other company’s directors, or (c) “exercises a controlling influence over the [other company’s] management or policies.”²⁷ The concepts of “control” and “controlling influence” are broadly defined; the Federal Reserve’s determination of whether a company exercises a controlling influence over another is based on a fact-specific analysis of the contours of the business relationship, such as the company’s total equity ownership and board representation. As a result, a creditor that has a business relationship with a settlement service provider, such as an appraisal company or title insurance agency, may be deemed to be an affiliate of that provider – regardless of whether the creditor controls the service provider from an operational perspective or whether it retains any of the charges for services provided.

One item that the Bureau concluded is also not excluded from “points and fees” under this provision is a point charged to the consumer to offset loan-level price adjustments (“LLPAs”) imposed by the Government Sponsored Enterprises (“GSEs”). GSEs make LLPAs — effectively discounts on what they are willing to pay for a loan — to compensate for added credit risks, such as a low credit score. Some creditors have offset lost revenue resulting from

²⁴ Cmt. 1026.32(b)(1)(C)-2.

²⁵ 12 C.F.R. § 1026.32(b)(1)(i)(D).

²⁶ 12 C.F.R. § 1026.32(b)(5).

²⁷ 24 C.F.R. § 1841(a)(2).

LLPAs by transferring the cost to consumers in the form of points.²⁸ The Bureau reasoned that the “manner in which creditors respond to LLPAs is better viewed as a fundamental component of how the pricing of a mortgage loan is determined rather than as a third-party charge.”²⁹ Thus, the Bureau explained that such points may be excluded from “points and fees,” if at all, only via the “bona fide discount points” exclusion, discussed in the next section below.³⁰

What is left of this exclusion for “bona fide third-party charge[s] not retained by the creditor, loan originator, or an affiliate of either” seems to be largely duplicative of other exclusions, particularly the exclusion for many types of (reasonable) real estate related fees paid to third party non-affiliates in § 1026.32(b)(1)(iii), discussed below, and pre-existing exclusions from the finance charge, such as the exclusion of property insurance premiums where the consumer chooses the insurer.³¹ (The Commentary to the new Rule makes clear that except as otherwise specified by it, items excluded from the finance charge in § 1026.4 are excluded from “points and fees.”³²)

(5) Certain “Bona Fide Discount Points” on Lower Interest Loans

The final exception to the general principle that non-interest finance charges are “points and fees” concerns “bona fide discount points.” A “bona fide discount point” is “an amount equal to 1 percent of the loan amount paid by the consumer that reduces the interest rate ... based on a calculation that is consistent with established industry practices.”³³ The Commentary provides detailed guidance on how a creditor can show that its calculation satisfies this “bona fide” standard.³⁴

The Rule excludes varying amounts of “bona fide discount points” depending on how close the undiscounted interest rate is on the date the rate is set to the APOR, which, as noted above, is a term borrowed from the Bureau’s “higher-priced mortgage loan” regulation at 12 C.F.R. § 1026.35.³⁵ Effectively, this provision discourages creditors from offering less creditworthy borrowers the option of paying discount points.

This exclusion specifically allows creditors to exclude:

- up to two bona fide discount points if the pre-discounted interest rate does not exceed the APOR by more than one percentage point; and
- up to one bona fide discount point if the pre-discounted rate does not exceed the APOR by more than two percentage points.

²⁸ *High-Cost Final Release* at 146-47.

²⁹ *Id.* at 146.

³⁰ *Id.* at 147.

³¹ 12 C.F.R. § 1026.4(d)(2).

³² *See* Cmt. 1026.32(b)(1)(i)-1.

³³ 12 C.F.R. § 1026.32(b)(3)(i).

³⁴ Cmt. 1026.32(b)(3)-1.

³⁵ Cmt. 1026.32(b)(1)(i)(E)-2.

The Commentary provides useful numerical examples of how this exclusion applies in practice.³⁶

2. Loan Originator Compensation

New 12 C.F.R. § 1026.32(b)(1)(ii) includes in the calculation of points and fees “[a]ll compensation paid directly or indirectly by a consumer or creditor to a loan originator ... that can be attributed to that transaction at the time the interest rate is set.” This one sentence raises many issues, which are addressed in both the Rule and the Concurrent Proposal.³⁷

First, vocabulary:

- “Compensation” includes the dollar value of monetary and non-monetary rewards, such as “a bonus, commission, or award of merchandise, services, trips, or similar prizes.” It is not dependent on what it is called, but rather includes whatever the loan originator retains.³⁸
- “Loan originator” or “LO” is defined by cross reference to the loan originator compensation rules. Under those rules, “loan originator” means a person who for — or in expectation of — compensation, arranges, negotiates, or otherwise obtains a loan for another person.³⁹ Because the word “person” in this definition includes both individuals and organizations, “loan originator” can include a mortgage brokerage, employees hired by either a brokerage or a creditor, and independent individual mortgage brokers. But it excludes a creditor that provides the funds for the transaction.⁴⁰ We use “creditor” below in that sense.

Issues raised by this provision can be grouped into four categories, which we discuss in turn below: (a) What compensation can be “attributed to [the] transaction” at issue?; (b) When is the amount of attributable compensation determined?; (c) How to address the issue of double-counting that arises within the four corners of this provision, new § 1026.32(b)(1)(ii)?; and (d) How to address double-counting issues that arise from the interaction of this provision and new § 1026.32(b)(1)(i), which as discussed above includes in points and fees non-interest finance charges with exceptions?

a. Attributing Compensation to a Particular Transaction

The Rule counts as “points and fees” only amounts “that can be attributed to [the] transaction.” The Commentary explains that this means the amount the loan originator will

³⁶ See Cmts. 1026.32(b)(1)(i)(E)-3 and 1026.32(b)(1)(i)(F)-2.

³⁷ The Bureau concurrently issued a proposal seeking comments on potential amendments to the Ability-to-Repay rule. Bureau of Consumer Financial Protection, Proposed Amendments to the Ability to Repay Standards under the Truth in Lending Act (Regulation Z) (Jan. 10, 2013), http://files.consumerfinance.gov/f/201301_cfpb_concurrent-proposal_ability-to-repay.pdf (publication in the Federal Register forthcoming) [hereinafter “*Concurrent Proposal Release*”].

³⁸ Cmt. 1026.32(b)(1)(ii)-1, -2.

³⁹ 15 U.S.C. § 1026.36(a)(1).

⁴⁰ Cmt. 1026.36(a).

receive if the particular transaction is consummated. It excludes compensation that cannot be attributed to the transaction at issue, such as:

- compensation based on the long term performance of the loan originator’s loans;
- compensation based on the overall quality of a loan originator’s loan files; and
- the base salary of an LO.⁴¹

The Commentary provides several examples applying this attribution concept at Cmt. 1026.32(b)(1)(ii)-4.

b. When is the Amount of Attributable Compensation Determined?

As the Rule provides, the amount of compensation is calculated “at the time the interest rate is set.”⁴² Subsequent events that might change what the loan originator is ultimately entitled to on the transaction — such as, for example, an increase in the per transaction commission resulting from the loan originator originating enough additional loans to surpass a volume target — have no effect on the calculation. The time when the compensation is actually paid to the loan originator also is not relevant.⁴³ Cmt. 32(b)(1)(ii)-3 provides a numerical example of this timing rule.

c. Double-Counting Issues Within the Four Corners of New § 1026.32(b)(1)(ii)

The inclusion in “points and fees” of loan originator compensation “paid *directly or indirectly* by a consumer or creditor to a *loan originator*” creates a major double-counting issue for the mortgage broker industry because both a mortgage brokerage and an employee of it that worked on the transaction are “loan originators.”⁴⁴ For example, assume a consumer or creditor pays \$1,000 to a mortgage brokerage, which passes along \$500 of that amount to its employee.⁴⁵ Because both the brokerage and the employee are “loan originators,” each of the two payments would be included in “points and fees”: the first as a “*direct[]*” payment from a “consumer or creditor to a loan originator,” and the second as an “*indirect[]*” payment from a “consumer or creditor to a loan originator.” Thus, even though the two “loan originators” keep only a total of \$1,000 between them, the amount included in “points and fees” would be \$1,500.

⁴¹ Cmt. 1026.32(b)(1)(ii)-2.

⁴² 12 C.F.R. § 1026.32(b)(1)(ii).

⁴³ Cmt. 32(b)(1)(ii)-3.

⁴⁴ 12 C.F.R. § 1026.32(b)(1)(ii) (emphasis added).

⁴⁵ Regulation Z currently provides that where a loan originator receives compensation directly from a consumer in connection with a mortgage loan, no loan originator may receive compensation from another person in connection with the same transaction. 12 C.F.R. § 1026.36(d)(2). Under the “Loan Originator Compensation under the Truth in Lending Act” Final Rule, released by the Bureau January 20, 2013, however, a mortgage brokerage may, from a consumer payment to it, pay its loan originator employees commissions, provided that the commissions cannot be based on the terms of the loans that they originate. 12 C.F.R. § 1026.36(d)(2)(i)(C). See http://files.consumerfinance.gov/f/201301_cfpb_final-rule_loan-originator-compensation.pdf.

Fortunately, the Bureau in the Concurrent Proposal has included a comment that would reverse that result if the Bureau adopts the proposed comment as currently written. Specifically, the comment would provide that “[c]ompensation paid by a mortgage broker to its individual loan originator employee is not included in points and fees.” Thus, in the example above, the \$1,000 “*direct[]*” payment would be included in “points and fees,” but the \$500 “*indirect[]*” payment would not be.⁴⁶

d. Double-Counting Issues Between New § 1026.32(b)(1)(i) and (ii)

Double-counting issues between these two provisions arise because fees paid by a consumer to either a mortgage brokerage or a creditor are non-interest finance charges that are included in “points and fees” by 12 C.F.R. § 1026.32(b)(1)(i). The issues presented by the consumer’s payments to the two entities are different, however.

In the former case, because a mortgage brokerage is a “loan originator,” *the very same fee* from the consumer to the mortgage brokerage would be both a non-interest finance charge under Paragraph (i) of § 1026.32(b)(1) and “compensation paid directly ... by a consumer ... to a loan originator” under Paragraph (ii). The same fee would therefore be counted twice under the Rule as the Bureau finalized it. Fortunately once again, however, the Bureau in its Concurrent Proposal has included a comment that would reverse this result. Specifically, the comment would provide that “[m]ortgage broker fees already included in the points and fees calculation under § 1026.32(b)(1)(i) [*i.e.*, payments by consumers to mortgage brokers] — need not be counted again under § 1026.32(b)(1)(ii).”⁴⁷

The latter case, where the consumer pays a fee to the creditor, presents a different double-counting issue. Here, there is no problem of double counting *the very same fee*, because a creditor (as we are using the term here) is not a loan originator; accordingly, the payment is included in “points and fees” only in Paragraph (i) of § 1026.32(b)(1) and not under Paragraph (ii). Instead, the problem arises where the creditor passes along part or all of the fee to an employee or to a mortgage brokerage, both of which *are* loan originators. That second payment, under the Rule as finalized, is “compensation paid directly by a ... creditor to a loan originator” (as well as “compensation paid ... indirectly by a consumer ... to a loan originator,” for that matter). Thus, if the consumer paid the creditor a \$3,000 fee and the creditor passed along \$1,500 of that amount to an employee or to a mortgage brokerage, \$4,500 would be included in “points and fees”.

In the Concurrent Proposal, the Bureau is proposing comment on two alternatives to address this result. Alternative 1 would confirm it, largely on the ground that — in the Bureau’s view — the result accords with congressional intent.⁴⁸ Alternative 2 would reverse the result by providing that a creditor must “reduce the amount of loan originator compensation included in

⁴⁶ Proposed Cmt. 1026.32(b)(1)(ii)-5.ii.

⁴⁷ Proposed Cmt. 1026.32(b)(1)(ii)-5.i. Presumably, the Bureau is using “mortgage broker” as it is defined in the loan originator compensation regulation, § 36; that definition refers to both a mortgage brokerage and an independent individual broker.

⁴⁸ See *Concurrent Proposal Release* at 60, 62-63.

the points and fees calculation under § 1026.32(b)(1)(ii) by any amount included in the points and fees calculation under § 1026.32(b)(1)(i).” In the example above, therefore, the \$3,000 fee included under Paragraph (i) would reduce to \$0 the \$1,500 payment to the creditor’s employee or mortgage brokerage otherwise includable under Paragraph (ii), leaving \$3,000 as the amount to be included in “points and fees.” And, if the consumer’s payment to the creditor were only \$1,000 and the creditor in turn paid its employee or mortgage brokerage a higher amount, \$1,500, the \$1,000 included in Paragraph (i) would reduce the \$1,500 otherwise includable under Paragraph (ii) to \$500, leaving the amount to be included in “points and fees” equal to \$1,000 from Paragraph (i) plus \$500 from Paragraph (ii), or \$1,500 in total.⁴⁹

3. Charges for Certain Real Estate Related Services

Also included in “points and fees” are certain charges for real estate related services. We will describe what we mean by “real estate related services” below, but first wish to note the circumstances under which they are included in “points and fees.” Specifically, they will be included where:

- the charge is paid to an affiliate of the creditor;
- the creditor receives direct or indirect compensation in connection with the charge; or
- the charge is unreasonable.⁵⁰

The inclusion of charges paid to an affiliate of the creditor will place severe stress on the many lenders who, for reasons of convenience and otherwise, affiliate with settlement service providers.

The charges for the “real estate related services” at issue are all “items listed in § 1026.4(c)(7) (other than amounts held for future payment of taxes).”⁵¹ Section 4(c)(7) lists the following:

- fees for title examination, abstract of title, title insurance, property survey, and similar purposes;
- fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents;
- notary and credit-report fees;
- property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest-infestation or flood-hazard determinations; and
- amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

4. Premiums for Credit Insurance and Debt Cancellation or Suspension Coverage “Payable at or Before Consummation”

⁴⁹ Proposed Cmt. 1026.32(b)(1)(ii)-5.iii (Alternative 2).

⁵⁰ 12 C.F.R. § 1026.32(b)(1)(iii).

⁵¹ 12 C.F.R. § 1026.32(b)(1)(iii).

“Points and fees” also includes the following three related types of charges, but only where they are “payable at or before consummation”:

- any credit life, credit disability, credit unemployment, or credit property insurance⁵²
- any other life, accident, health, or loss-of-income insurance for which the creditor is a beneficiary, and
- any payments directly or indirectly for any debt cancellation or suspension agreement or contract.⁵³

The Commentary clarifies that so long as these charges are “payable at or before consummation,” it does not matter whether they are paid in cash or, if permitted by applicable law, financed.” The Commentary also states that whether the credit insurance or debt cancellation coverage is “optional or required” is immaterial to the determination of whether the charges are included as points and fees.⁵⁴

5. Prepayment Penalties

Certain prepayment penalties also are counted toward the “points and fees” trigger for high cost mortgages. Specifically, both of the following are included in “points and fees”:

- the maximum “prepayment penalty” that may be charged or collected under the terms of the mortgage loan; and
- the total “prepayment penalty” that would be incurred by the consumer if the consumer were to refinance the existing mortgage loan with any of the following: (a) the current holder of the existing loan, (b) a servicer acting on behalf of the current holder, or (c) an affiliate of either.⁵⁵

As the Bureau acknowledges, the inclusion of these contingent charges in “points and fees” represents an exception to the general rule that the “known at or before consummation” limitation on points and fees means that the creditor must know “that the charge or fee will be imposed.”⁵⁶ The creditor obviously does not know whether a prepayment penalty will be imposed, but the amount of such a contingent charge is nonetheless part of “points and fees.”

G. Definition of Points and Fees for HELOCs

Points and fees in an open-end consumer credit transactions are defined the same as for closed-end mortgage loans, with two additional components:

⁵² “Credit property insurance,” the Commentary explains, is “insurance against loss of or damage to personal property, such as a houseboat or manufactured home;” it “covers the creditor’s security interest in the property;” and does “not include homeowners’ insurance, which, unlike credit property insurance, typically covers not only the dwelling but its contents and protects the consumer’s interest in the property.” Cmt. 1026.32(b)(1)(iv)-2.

⁵³ 12 C.F.R. § 1026.32(b)(1)(iv).

⁵⁴ Cmt. 1026.32(b)(1)(iv)-1.

⁵⁵ 12 C.F.R. § 1026.32(b)(1)(v) and (vi).

⁵⁶ Cmt. 1026.32(b)(1)-1.i, ii.

- Any fees charged for participation in an open-end credit plan, payable at or before account opening, as described in 12 C.F.R. § 1026.4(c)(4); and
- Any transaction fee, including any minimum fee or per-transaction fee, that will be charged for a draw on the credit line, where the creditor must assume that the consumer will make at least one draw during the term of the plan.⁵⁷

H. Applicable Threshold

For purposes of determining whether a loan meets the points and fees test under 12 C.F.R. § 1026.32(a)(1)(ii), a creditor must determine the applicable points and fees threshold based on the face amount of the note (or, in the case of an open-end credit plan, the credit limit for the plan when the account is opened). However, the creditor must apply the allowable points and fees percentage to the “total loan amount,” as defined in § 1026.32(b)(4).

III. New Restrictions and Disclosures

For loans which meet one of the high cost mortgage tests and are considered high-cost, there are new restrictions on such loans, briefly summarized as follows:

A. Balloon Payments

The payment schedule may not include a payment that is more than two times a regular periodic payment. However, this prohibition does not apply to (i) a payment schedule adjusted to the seasonal or irregular income of the consumer, (ii) a bridge loan of 12 months or less connected with the acquisition or construction of a dwelling intended to become the consumer’s principal dwelling, or (iii) loans made by creditors operating predominantly in rural or underserved area and meeting other criteria.⁵⁸ For an open-end credit plan, “regular periodic payment” means the required minimum periodic payment.⁵⁹

If the terms of an open-end credit plan provide for a prepayment period during which no further draws may be taken, the prohibition does not apply to any adjustment in the regular periodic payment that results solely from the credit plan’s transition from the draw period to the repayment period.⁶⁰

B. Prepayment Penalties

Prepayment penalties are not allowed.⁶¹ For a closed-end credit transaction, prepayment penalty means a charge imposed for paying all or part of the transaction’s principal before the date on which the principal is due, other than a waived, bona fide third-party charge that the creditor imposes if the consumer prepays all of the transaction’s principal sooner than 36 months after consummation, except that interest charged consistent with the monthly interest accrual

⁵⁷ 12 C.F.R. § 1026.32(b)(2).

⁵⁸ 12 C.F.R. § 1026.32(d)(1).

⁵⁹ Cmt. 1026.32(d)(1).

⁶⁰ 12 C.F.R. § 1026.32(d)(1).

⁶¹ 12 C.F.R. § 1026.32(d)(6)-(7).

amortization method is not a prepayment penalty for FHA loans consummated before January 21, 2015.

For an open-end credit plan, prepayment penalty means a charge imposed by the creditor if the consumer terminates the open-end credit plan prior to the end of its term, other than a waived bona fide third-party charge that the creditor imposes if the consumer terminates the open-end credit plan sooner than 36 months after account opening.⁶²

C. Ability-to-Repay for HELOCs

Creditors originating open-end loans are required to assess the consumer's ability to repay the loan. (Creditors originating high-cost closed-end loans are required to do so under the Bureau's new ability-to-repay rule issued the same day as this Rule, set forth in 12 C.F.R. § 1026.43.) Creditors must consider the consumer's current and reasonably expected income, employment, assets other than the collateral, and current obligations including any mortgage-related obligations that are required by another credit obligation undertaken prior to or at account opening, and are secured by the same dwelling that secures the high-cost mortgage transaction. Creditors are required to verify (i) income or assets, including expected income or assets, and (ii) the consumer's current obligations, including any mortgage-related obligations that are required by another credit obligation undertaken prior to or at account opening, and are secured by the same dwelling. Bridge loans of 12 months or less are exempt from this requirement.⁶³ Creditors are required only to consider repayment ability based on the facts and circumstances known to the creditor at the time of account opening, and a creditor is not in violation of this provision if a consumer defaults because of a reduction in income or obligation that occurs after account opening.⁶⁴

D. Encouraging Default

Creditors and mortgage brokers must not recommend or encourage a consumer to default on an existing loan or other debt in connection with consummating or opening a high-cost mortgage that refinances all or part of that loan or debt.⁶⁵ For example, the creditor must not advise the consumer to stop making payments in a manner that is likely to cause the consumer to default on the loan.⁶⁶

E. Servicing Fees

There are several restrictions on servicing fees.

- Modification fees and deferral fees are prohibited.⁶⁷
- Fees for payoff statements are generally banned; however, creditors and servicers may charge a reasonable fee once the creditor or servicer has provided such

⁶² 12 C.F.R. § 1026.32(b)(6).

⁶³ 12 C.F.R. § 1026.34(a)(4).

⁶⁴ Cmt. 1026.34(a)(4).

⁶⁵ 12 C.F.R. § 1026.34(a)(6).

⁶⁶ Cmt. 1026.34(a)(6).

⁶⁷ 12 C.F.R. § 1026.34(a)(7).

information four times during a calendar year. Furthermore, creditors and servicers may charge a processing fee for providing a payoff statement by fax or courier, provided the fee is comparable to fees imposed for similar services provided for non-high-cost loans and provided the creditor or servicer discloses that other delivery options are available without charge.⁶⁸

- Late fees are restricted to four percent of the amount past due, must be specifically permitted by the terms of the loan documents, and may not be imposed more than once for a single late payment. Furthermore, payments may not be applied in a way that results in the pyramiding of late fees.⁶⁹ Late fees may only be imposed after a payment is 15 days past due (or 30 days for loans on which interest on each installment is paid in advance).⁷⁰

F. No Financing of Points and Fees

Points and fees that are required to be included in the calculation of points and fees may not be financed.⁷¹ For example, points and fees are financed if they are added to the loan balance or financed through a separate note, if the note is payable to the creditor or an affiliate.⁷²

G. New Disclosures

The Rule also revises various consumer disclosure requirements for high-cost mortgages to distinguish between closed-end and open-end loans, and adds new disclosures specific to open-end loans. Creditors must make these disclosures within three business days before consummating a closed-end high cost mortgage or opening the account for an open-end high cost mortgage, unless the consumer waives in writing the three-day waiting period because the credit is needed to meet a bona fide personal financial emergency.⁷³

For closed-end loans, the creditor must disclose the amount of the regular monthly (or other periodic) payment and the amount of any balloon payment provided in the contract. The creditor must also disclose the total amount the consumer will borrow, as reflected by the face amount of the note, and if this amount includes finance charges not otherwise prohibited, that fact must be included as well. The disclosure of the amount borrowed will be treated as accurate if it is not more than \$100 above or below the amount required to be disclosed.⁷⁴ The regular payment is the amount due from the consumer at regular intervals, but the amounts for voluntary items (e.g. credit life insurance), may be included in the regular payment disclosure only if the consumer previously agreed to those amounts. If the loan has multiple payment levels, the regular payment for each level must be included in the disclosure.⁷⁵

⁶⁸ 12 C.F.R. § 1026.34(a)(9).

⁶⁹ Cmt. 1026.34(a)(8).

⁷⁰ 12 C.F.R. § 1026.34(a)(8).

⁷¹ 12 C.F.R. § 1026.34(a)(10).

⁷² Cmt. 1026.34(a)(10).

⁷³ 12 C.F.R. § 1026.31(c).

⁷⁴ 12 C.F.R. § 1026.32(c).

⁷⁵ Cmt. 1026.32(c).

For open-end loans, the creditor must provide an example, based on assumptions specified in the Rule, showing the first minimum periodic payment for the draw period, the first minimum periodic payment for any repayment period, and the balance outstanding at the beginning of any repayment period. If the contract provides for a balloon payment, the creditor must also disclose that fact and provide an example showing the amount of the balloon payment. The creditor must also provide statements that the example payments (i) show the first minimum periodic payments at the current annual percentage rate if the consumer borrows the maximum credit available when the account is opened and does not obtain any additional extensions of credit, or a substantially similar statement, and (ii) are not the consumer's actual payments and that the actual minimum periodic payments will depend on the amount the consumer borrows, the interest rate applicable to that period, and whether the consumer pays more than the required minimum periodic payment, or a substantially similar statement. Finally, the creditor must disclose the credit limit for the plan when the account is opened.⁷⁶

For variable-rate transactions, the creditor must disclose a statement that the interest rate and monthly payment may increase and the amount of the single maximum monthly payment based on the maximum interest rate.⁷⁷ If the loan has multiple payment levels and more than one maximum payment amount is possible, the maximum payment for each level must be included in the disclosure.⁷⁸

IV. Cure Provision for HOEPA Violations

The Rule implements new section 129(v) of TILA, 15 U.S.C. §1639(v), added by Dodd-Frank, which prescribes certain conditions under which a creditor or assignee of a high-cost mortgage may take steps to cure a HOEPA violation. Specifically, under new Regulation Z §1026.31(h), a creditor or assignee in a high-cost mortgage who, when acting in good faith, failed to comply with any HOEPA requirement will not be deemed to have violated such requirement if the creditor or assignee satisfies either of the following sets of conditions, one which requires action within 30 days of consummation (or account opening, for HELOCs), and one which requires action within 60 days of discovery of the error:

A. Within 30 Days of Closing

- Within 30 days of consummation or account opening and prior to the institution of any action, the consumer is notified of or discovers the violation;
- Appropriate restitution is made within a reasonable time; and
- Within a reasonable time, whatever adjustments are necessary are made to the loan or credit plan to either, at the choice of the consumer:
 - Make the loan or credit plan satisfy the requirements of HOEPA; or
 - Change the terms of the loan or credit plan in a manner beneficial to the consumer so that the loan or credit plan will no longer be a high-cost mortgage;⁷⁹ or

⁷⁶ 12 C.F.R. § 1026.32(c).

⁷⁷ 12 C.F.R. § 1026.32(c).

⁷⁸ Cmt. 1026.32(c).

⁷⁹ 12 C.F.R. § 1026.31(h)(1).

B. Within 60 Days of Discovery

- Within 60 days of the creditor’s discovery or receipt of notification of an unintentional violation or bona fide error and prior to the institution of any action, the consumer is notified of the compliance failure;
- Appropriate restitution is made within a reasonable time; and
- Within a reasonable time, whatever adjustments are necessary are made to the loan or credit plan to either, at the choice of the consumer:
 - Make the loan or credit plan satisfy the requirements of HOEPA; or
 - Change the terms of the loan or credit plan in a manner beneficial to the consumer so that the loan or credit plan will no longer be a high-cost mortgage.⁸⁰

Note that under Section 130(c) of TILA, the provision allowing a “bona fide error” defense to civil liability under the Act, “[e]xamples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programing, and printing errors, except that an error of legal judgment with respect to a person’s obligations under this title is not a bona fide error.”⁸¹

Under the Commentary to new § 1026.31(h), for notice to be adequate, the consumer should have at least 60 days in which to consider the available options and communicate a choice to the creditor or assignee. Moreover, what length of time is reasonable will depend on what changes to a loan or credit plan’s documentation, disclosure, or terms are necessary to effectuate the adjustment. In general, according to the Commentary, implementing appropriate restitution and completing an adjustment within 30 days of the consumer’s providing notice of the election can be considered reasonable.⁸²

V. Counseling Requirements

A. Counseling Requirements for High-Cost Mortgages

The Rule also includes new requirements related to homeownership counseling. Creditors must ensure that consumers receive homeownership counseling before extending a high-cost loan. The consumer must receive this counseling after receiving either the good faith estimate or the disclosures required to be provided to open-end credit plan applicants by 12 C.F.R. § 1026.40.⁸³ This counseling must be provided by a federally certified or approved homeownership counselor and may not be provided by an employee or affiliate of the creditor. Furthermore, the creditor may not steer a consumer to choose a particular counselor. The creditor must receive a written certification which includes the consumer’s name, the date of counseling, the name and address of the counselor, a statement that the consumer received counseling on the advisability of the high-cost mortgage, and a statement that the counselor verified that the consumer received the disclosures required by 12 C.F.R. § 1026.32(c) or

⁸⁰ 12 C.F.R. § 1026.31(h)(2).

⁸¹ 15 U.S.C. § 1640(c).

⁸² Cmt 1026.31(h) – 1,2.

⁸³ See note 90 below.

RESPA. This statement does not require the counselor to have made a judgment or determination as to the appropriateness of the mortgage transaction for the consumer.⁸⁴

Creditors may pay the counseling fees and may confirm that the counseling took place but may not condition the payment of such fees on the consummation or account-opening of the high-cost mortgage.⁸⁵ Alternatively, these fees may be financed.⁸⁶ Before receiving certification of counseling, a creditor may not extend a high-cost mortgage, but may engage in other activities, such as processing an application that will result in the extension of a high-cost mortgage (e.g., ordering an appraisal or title search).⁸⁷

B. Counseling Requirements for Negative Amortization Mortgages

In addition, and regardless of whether the loan is high-cost, creditors must ensure that first-time borrowers receive homeownership counseling before making closed-end loans that may result in negative amortization (except with respect to reverse mortgages and timeshare loans). This counseling must be provided by a federally certified or approved homeownership counselor, and the creditor may not steer a consumer to choose a particular counselor.⁸⁸ The counseling must include information regarding the risks and consequences of negative amortization. The creditor must receive documentation that the consumer obtained this counseling before extending credit, such as a certificate, letter, or email.⁸⁹

C. List of Homeownership Counseling for Federally Related Mortgage Loans

The Rule also amends Regulation X to require that within three days of receipt of an application by a lender, a mortgage broker, or a dealer, the lender must provide the applicant a clear and conspicuous list of homeownership counseling organizations that provide relevant counseling services in the loan applicant's location.⁹⁰ For applications for a HELOC, the list may be provided within this time frame or within the timeframe for the HELOC application disclosures under Regulation Z.⁹¹ A mortgage broker or dealer may provide the list to any loan applicant from whom it receives or for whom it prepares an application, and if the mortgage broker or dealer has provided the required list, the lender is not required to provide an additional list. The lender, however, is the party responsible for ensuring that the list is timely provided to the loan applicant.⁹²

The Bureau intends to create a website portal, in coordination with HUD, that will require lenders to input certain required information (such as, for example, the applicant's zip code and

⁸⁴ Cmt. 1026.34(a)(5).

⁸⁵ 12 C.F.R. § 1026.34(a)(5).

⁸⁶ Cmt. 1026.34(a)(5).

⁸⁷ Cmt. 1026.34(a)(5).

⁸⁸ 12 C.F.R. § 1026.36(k).

⁸⁹ Cmt. 1026.36(k).

⁹⁰ 12 C.F.R. § 1024.20(a)(1).

⁹¹ Under 12 C.F.R. § 1026.40(b), the disclosures and brochure required by paragraphs (d) and (e) of this section shall be provided at the time an application is provided to the consumer. The disclosures and the brochure may be delivered or placed in the mail not later than three business days following receipt of a consumer's application in the case of applications contained in magazines or other publications, or when the application is received by telephone or through an intermediary agent or broker.

⁹² 12 C.F.R. § 1024.20(a)(3).

the type of mortgage product) in order to generate a list of homeownership counseling organizations that provide relevant counseling services in the loan applicant's location. To ensure that the applicant receives a current list, lenders (or mortgage brokers or dealers, if applicable) must obtain the list from this website portal (or from other data provided by the Bureau or HUD) no earlier than 30 days prior to the time when the list is provided to the loan applicant.⁹³ The list can generally be combined with other disclosures provided under Regulation X or Regulation Z.⁹⁴

This requirement applies to applications for federally related mortgage loans, including refinancings, home equity loans and HELOCs. It does not apply to reverse mortgage transactions subject to 12 CFR 1026.33(a) and timeshare plans.⁹⁵

As with other RESPA disclosures (Good Faith Estimate, Home Buyer Information Booklet), the lender is not required to provide the list of homeownership counseling organizations if, before the end of the three-business-day period after application, the lender denies the application or the loan applicant withdraws the application.⁹⁶

If a mortgage loan transaction involves more than one lender, only one list shall be given to the loan applicant and the lenders shall agree among themselves which lender will give it. If there is more than one applicant, the list may be provided to any loan applicant with primary liability on the loan.⁹⁷

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Questions regarding the matters discussed in this Alert may be directed to any our lawyers listed below, or to any other BuckleySandler attorney with whom you have consulted in the past.

- Jeffrey P. Naimon, (202) 349-8030, jnaimon@buckleysandler.com
- Clinton R. Rockwell, (310) 424-3901, crockwell@sandler.com
- John P. Kromer, (202) 349-8040, jkromer@buckleysandler.com
- Joseph M. Kolar, (202) 349-8020, jkolar@buckleysandler.com

⁹³ 12 C.F.R. § 1024(a)(1).

⁹⁴ 12 C.F.R. § 1024(a)(2).

⁹⁵ 12 C.F.R. § 1024.20(c).

⁹⁶ 12 C.F.R. § 1024.20(a)(5).

⁹⁷ 12 C.F.R. § 1024.20(a)(6).