BROWN, FOWLER & ALSUP
A Professional Corporation
Attorneys at Law

J. Alton Alsup
Board Certified in Residential Real Estate Law
Texas Board of Legal Specialization

10333 Richmond, Suite 860
Houston, Texas 77042
www.LoanLawyers.com

Telephone 713/468-0400
Facsimile 713/468-5335
AlAlsup@BFAlegal.com

MEMORANDUM

TO: Clients and Friends of the Firm

FROM: Al Alsup

DATE: December 15, 2012

SUBJECT: The Looming Regulatory Cliff — Overview of New Regulations Proposed by the Consumer Financial Protection Bureau to Implement Home Mortgage Reforms of the Dodd-Frank Act

---

The Consumer Financial Protection Bureau (the "CFPB") was created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") in 2010 to administer and enforce federal consumer finance law. All rulemaking and enforcement authority for the Real Estate Settlement Procedures Act ("RESPA" and "Reg. X"), the Truth in Lending Act (TILA and Reg. Z), the Equal Credit Opportunity Act (ECOA and Reg. B), the Home Mortgage Disclosure Act (HMDA and Reg. C) and other federal statutes regulating consumer finance was transferred to, and consolidated within, the new CFPB as of July 21, 2011. In the coming months, the CFPB is required to adopt new mortgage finance regulations to implement and interpret the extensive reform measures of the Dodd-Frank Act. To date, the CFPB has under consideration seven proposed rules outlined in this memorandum. These Proposed Rules have been published in the Federal Register (F.R.) for public comment as the first stage of the federal administrative rulemaking process. The CFPB expects to adopt Final Rules during calendar year 2013.

In an effort to coordinate the effective dates of these expected final rules, the CFPB gave notice on November 16, 2012 that it is amending Regulation Z (Truth in Lending) to effectively delay implementation of rules and forms required by Title XIV of the Dodd-Frank Act that otherwise would have automatically taken effect on January 21, 2013. Title XIV in part amends the Truth in Lending Act to require mortgage lenders to provide various disclosures before and/or after loan consummation regarding such matters as a loan's negative amortization features, state law anti-deficiency protections, monthly payments and repayment analysis of ARM and hybrid ARM loan transactions, settlement charges, including mortgage originator fees and interest as a percentage of loan principal, the lender's policies on partial payments, mandatory escrow or impound accounts, waiver of escrow accounts and cancellation of escrow after loan consummation, and certain notifications regarding appraisals.

The CFPB instead intends to implement these Title XIV consumer disclosures as part of its later rulemaking in which mortgage disclosure forms that consumers receive under the Truth in Lending Act and the Real Estate Settlement Procedures Act when applying for and closing on a home mortgage loan will be integrated into a single set of disclosures as required by Title X of the Dodd-Frank Act and outlined in 2. of this memorandum. By delaying the implementation of the Title XIV disclosure rules to coincide with the integrated RESPA and TILA disclosure rules, the CFPB hopes to reduce the consumer confusion and compliance burden on the industry caused by a trickling down of multiple new rule releases over the coming months.

1. Publication of Federal Regulations with New Citations.

The various federal regulations transferred to the CFPB on July 21, 2011 have been republished in the Code of Federal Regulations (CFR) with only technical and conforming changes, including substituting the name of the CFPB for each of the federal agencies formerly delegated regulatory authority. New citations and links to certain of the new published federal regulations are:

- Regulation X (RESPA)
  New citation: 12 CFR part 1024
  Old citation: HUD Rule: 24 CFR part 3500
  New Regulation X: See http://www.gpo.gov/fdsys/pkg/FR-2011-12-20/pdf/2011-31722.pdf. (Pages 78981 to 79017)

- Regulation Z (TILA)
  New citation: 12 CFR part 1026
  Old citation: (FRB Rule: 12 CFR part 226).
  New Regulation Z: See http://www.gpo.gov/fdsys/pkg/FR-2011-12-22/html/2011-31715.htm. (Pages 79772 to 80080)

- Regulation N (Mortgage Acts and Practices — Advertising)
  New citation: 12 CFR part 1014
  New Regulation N: See http://www.gpo.gov/fdsys/pkg/FR-2011-12-16/pdf/2011-31731.pdf. (*Pages 78133 and 78134*)

- Regulation B (Equal Credit Opportunity Act)
  New citation: 12 CFR part 1002
  Old citation: *(FRB Rule: 12 CFR part 202)*.
  New Regulation B: See http://www.gpo.gov/fdsys/pkg/FR-2011-12-21/pdf/2011-31714.pdf. (Pages 79445 to 79483)

- Regulation C (Home Mortgage Disclosure Act)
  New citation: 12 CFR part 1003
  Old citation: *(FRB Rule: 12 CFR part 203)*.
  New Regulation C: See http://www.gpo.gov/fdsys/pkg/FR-2011-12-19/pdf/2011-31712.pdf. (Pages 78468 to 78483)

2. New Rules and Forms Integrating Consumer Disclosures under RESPA and TILA.

The CFPB has proposed new rules and forms mandated by the Dodd-Frank Act to combine truth-in-lending consumer disclosures required under TILA (the so-called “Initial TIL” at application and the “Final TIL” at consummation) with the Good Faith Estimate (GFE) and HUD-1 settlement statement (HUD-1) disclosures required under RESPA and has provided extensive guidance for compliance with those requirements. The Proposed Rule was published August 23, 2012 at 77 F.R. 51116 — 51457. The new rule and forms would apply only to closed-end credit transactions (i.e., HELOCs and reverse mortgages would be exempt). The proposals under consideration by the CFPB would consolidate the overlapping and, in some cases, duplicative mortgage disclosure regulations under TILA and RESPA into a single set of requirements and resolve any conflicts between the two.

- **New Form of Loan Estimate.** The GFE and Initial TIL disclosures would be replaced and combined into a single, new form to be known as the "Loan Estimate." This disclosure would summarize key loan terms and estimated loan and settlement costs and be provided to consumers at, or no later than three business days after, loan application. No creditor or other person could impose a fee on a consumer (other than a fee for a consumer credit report) until the consumer has received the Loan Estimate and has affirmatively indicated his intent to proceed with the transaction. Proposed sample forms of the Loan Estimate that have been consumer tested in independent studies are included in the proposed rule. (See Appendix H – 24(A) – 24(F) at 77 F.R. at pages 51333 – 51357.)

- **New Form of Closing Disclosure.** The HUD-1 settlement statement and the Final TIL disclosure would be replaced and combined into a single, new form to be known as the "Closing Disclosure." The Closing Disclosure would summarize final loan terms and costs and provide a detailed accounting of the transaction. Proposed sample forms of the Loan Estimate that have been consumer tested in independent studies are included in the proposed rule. (See Appendix H – 25(A) – 25(J) at 77 F.R. at pages 51358 – 51402.)

- **Timing of Closing Disclosure.** The Closing Disclosure would be required to be provided to the consumer no later than three business days prior to loan closing, and, if changes occur in the interim period before the date of closing, an updated Closing Disclosure generally would be required to be provided to the consumer and the closing date delayed for an additional three business days (with some minor exceptions). Reissuance of the Closing Disclosure and an additional three-day waiting period would be required only if during the three days after issuance of the Closing Disclosure (i) the APR in the Closing Disclosure increases by more than 1/8 %; (ii) an ARM, prepayment penalty, NegAm, interest only, balloon, or demand feature is added to the loan; or (iii) the amount needed to close the loan shown in the Closing Disclosure increases beyond a de minimis tolerance of not more than $100.

- **Responsibility for Providing Closing Disclosure.** The CFPB is considering alternative rules for assigning responsibility for preparation and delivery of the Closing Disclosure to the consumer three business days before closing. The first alternative would make the lender solely responsible for accurately preparing and timely delivering the Closing Disclosure to the consumer while the second alternative would allow the lender to rely on the settlement agent to prepare and deliver the Closing Disclosure, although the lender nevertheless would retain responsibility for its accuracy.

- **Lender's Disclaimer on Pre-Application Estimates.** Any form or disclosure that a lender or mortgage broker may provide a consumer prior to application that sets out estimates of loan terms or settlement costs would have to contain a prominent disclaimer indicating that any such form or disclosure is not the official Loan Estimate required by RESPA and TILA (although such a disclaimer would not be required for general advertisements).

- **Zero-Tolerance Restrictions on the Lender's Charging of Higher Closing Costs than Disclosed in Loan Estimate.** The "Zero Tolerance" limitation currently applicable to a loan originator's own charges would be expanded to apply to estimated charges of service providers owned or affiliated with the lender and third-party service providers selected by the lender, including service providers selected by the consumer from a list of service providers prepared by the lender. Generally, the proposed rule would prohibit any increase in the following charges over that disclosed in the Loan Estimate: (i) a mortgage lender's or mortgage broker's charges for its own services; (ii) charges for services provided by an affiliate of the lender or broker; and (iii) charges for services for which the lender or broker does not permit the consumer to shop. Other charges generally would have a tolerance in total not exceeding 10%. Exceptions to these tolerances may arise if and when (i) the consumer requests a change; (ii) the consumer is allowed to shop for a service and chooses a service provider not identified by the lender or broker; (iii) information provided by the consumer at application is found to be inaccurate or becomes inaccurate; or (iv) the Loan Estimate expires.

- **Lender's Required Records Retention.** Lenders would be required to maintain standardized, machine-readable, electronic versions of the Loan Estimate and Closing Disclosure forms they deliver to a consumer and the reasons for any changes in information provided in such disclosures for a retention period to be determined (e.g., 5 years).

- **Re-defining "Application.**" A lender or mortgage broker is not required to provide the consumer disclosures until an "application" is received. However, under current rules an application is considered received when the lender or mortgage broker has obtained seven (7) pieces of information including the borrower's name, monthly income, social security number**,** property address, estimate of property value, loan amount sought, and "any other information deemed necessary by the lender." The CFPB is considering adopting a rule removing the last of these pieces of information (i.e., "any other information deemed necessary") from the definition of "Application" to assure that the Loan Estimate is provided early in the process. Under the rule, any other information sought would have to be obtained within the three-business-day period after application before issuing the Loan Estimate.

- **Re-Defining "Finance Charge."** The standard disclosure of the cost of credit under TILA is the Annual Percentage Rate or APR, which is the Finance Charge expressed as a yearly rate. The Finance Charge is comprised mostly of interest, but also includes a lender's points and fees and other closing costs not expressly excluded from its definition. However, many real estate related closing costs are specifically excluded from the Finance Charge for home mortgage transactions (i.e., closed-end transactions secured by real property or a dwelling), including in particular real estate related charges set out in Reg. Z §1026.4(c)(7) such as costs and fees for credit reports, appraisal, survey, title insurance, and document preparation services. The CFPB is considering removing most of these exclusions to provide a simpler and more uniform calculation of the APR and to better allow the consumer to compare the total cost of one loan to another. The proposed rule accordingly would eliminate most of these so-called 4(c)(7) exclusions from the Finance Charge and APR calculation, resulting generally in higher but more uniform finance charge and APR calculations. However, as proposed, certain charges would continue to be excluded from the finance charge definition, including fees or charges payable in a comparable cash transaction, late fees and similar default or delinquency charges, seller's points, property insurance premiums, and amounts required to be deposited into escrow for future payment of property insurance and taxes.

Source: Proposed Rule published August 23, 2012 at 77 F.R. 51116 – 51457

3. New Rules for Satisfying TILA's "Ability to Repay" Underwriting Standards.

A creditor is prohibited under the Dodd-Frank Act from making a mortgage loan to a consumer without regard to the consumer's ability to repay the loan. This prohibition formerly applied only to certain higher cost loan transactions but now is expanded by the Dodd-Frank Act to apply to any consumer credit transaction secured by a first-lien on a principal dwelling (except open-end credits, timeshares, reverse mortgages, and temporary loans). The Federal Reserve Board (FRB) published a Proposed Rule on May 11, 2012 amending Regulation Z to implement Truth in Lending Act (TILA) changes made by the Dodd-Frank Act and the Public Comment Period expired July 22, 2011 but was reopened and extended to July 9, 2012 by Notice published by the CFPB. The CFPB must now publish a Final Rule implementing the Dodd-Frank Act statutory changes and establish standards for complying with "ability to repay" requirements, such as by the making of a "Qualified Mortgage."

The CFPB is considering establishing a general standard under which a lender could satisfy the requirement to determine a consumer's "ability to repay" if the lender considers and verifies the following eight underwriting factors in determining repayment ability:

- Borrower's current or reasonably expected income or assets;
- Borrower's current employment status;
- Monthly payment on the mortgage note (based upon fully indexed rate, if an ARM);
- Monthly payment on any simultaneous loan;
- Monthly payment for mortgage-related obligations;
- Borrower's current debt obligations;
- Monthly debt-to-income ratio, or residual income; and
- Borrower's credit history

Alternatively, the lender could satisfy the requirements by originating a "Qualified Mortgage," which would provide the creditor special protections from liability. The CFPB is considering whether a qualified mortgage should provide a creditor a *safe harbor* from liability or instead merely constitute a *rebuttable presumption of compliance* with the 'ability-to-repay' requirements.

Under the Proposed Rule, if deemed a legal safe harbor, a Qualified Mortgage would be defined as a mortgage for which:

- The loan does not provide for negative amortization, interest-only payments, or balloon payments, or a loan term exceeding 30 years;
- Total "points and fees" do not exceed 3% of the total loan amount;
- The borrower's income and/or assets are verified and documented; and
- Underwriting is based on (i) the maximum interest rate in the first five years of the loan term; (ii) a payment schedule that fully amortizes the loan over the loan term; and (iii) analysis that takes into account any mortgage-related obligations.

The Final Rule would also implement the Dodd-Frank Act's limits on prepayment penalties and require creditors to retain evidence of compliance with this rule for three years after the date of loan consummation.

Source: Proposed Rule published May 11, 2011 at 76 F.R. 27390 — 27506

4. New Rules and Forms for Mortgage Loan Servicing Requirements.

The Dodd-Frank Act mandates new consumer protection reforms in the servicing of their home mortgage loans, including (i) new disclosures required for periodic account statements, notices prior to reset of adjustable rate mortgages (ARMs), and notices prior to a servicer's imposing force-placed insurance coverage; (ii) new requirements for servicers to respond in a timely manner to borrowers who complain to the servicer about a potential mistake in their accounts and to inform the borrower how the complaint was resolved and why; (iii) prompt crediting of payments to avoid wrongfully penalizing the borrower with late fees; and (iv) prompt response to requests for payoff information.

In that regard, the CFPB published companion Proposed Rules on September 17, 2012 that would amend both Regulation Z and Regulation X to implement the Dodd-Frank Act provisions related to mortgage loan servicing to require:

- **Periodic Loan Statements.** Servicers would be required to provide periodic statements to borrowers for each billing cycle for closed-end credit transactions secured by a dwelling (except for fixed-rate loans with coupon books containing substantially the same information) that meet specific timing, form, and content requirements set out in the rule.

- **ARM Reset Notice.** Servicers would be required to provide written notice to a borrower whose mortgage has an ARM feature 60 to 120 days before an adjustment which causes the payment to change. The servicer would also be required to provide an earlier notice 210 to 240 days prior to the first rate adjustment that contains an estimate of the rate and payment change. Other than this initial notice, servicers would no longer be required to provide an annual notice if a rate adjustment does not result in an increase in the monthly payment. The proposed rule contains model and sample forms that servicers may use to comply with these notice requirements.

- **Force Placed Insurance Notices.** Servicers would be prohibited from charging a borrower for force-placed insurance unless the servicer has a reasonable basis to believe that the borrower has failed to maintain hazard insurance and has provided the borrower required notices. A notice would be required at least 45 days before charging for force-placed insurance and a second notice would be required no earlier than 30 days after the first notice. New regulatory requirements and procedures would be adopted that servicers must follow before charging consumers for such coverage, including a requirement that servicers must terminate such coverage and reimburse borrowers for premiums charged during any period of overlapping coverage. If a servicer has made payments of property insurance premiums from a borrower's escrow account, the servicer would be required to continue those payments instead of force-placing a separate policy — even if the escrow account has insufficient money on account. Any charges by the servicer related to force-placed insurance, other than charges authorized by law, must reasonably relate to a service actually performed and bear a reasonable relationship to the servicer's actual cost of providing the service. The proposed rule contains model forms that may be used by servicers to comply with these notice requirements.

- **Prompt Crediting of Payments.** Servicers of consumer credit secured by the consumer's principal dwelling would be required to credit scheduled borrowers' payments as of the date received (unless the failure to timely credit the payment does not result in a charge to the consumer or a reporting of negative credit information to a consumer reporting agency). Non-conforming payments would be required to be credited within five days after receipt. However, servicers would be allowed either to refuse partial payments in accordance with contract terms or to hold partial payments in a non-interest bearing suspense account until a full contractual payment is on deposit and then credit the full payment to the oldest delinquent payment owed on the account.

- **Prompt Payoff Information.** Servicers of a home loan (except reverse mortgages) would be required to send an accurate payoff balance within a reasonable time, but no later than seven (7) business days after receipt of a written request from, or on behalf of, a borrower.

- **Prompt Error Resolution Procedures.** New servicing rules would be expanded to apply to both first- and subordinate-lien closed-end home loans. Servicers would be required (i) to respond within 10 business days to a borrower's request for the identity and contact information of the owner or assignee of the loan; and (ii) when receiving a 'qualified written request' (including enough information to enable the servicer to identify the name and account and understand the type of error the borrower believes has occurred and when the error occurred), the servicer would be required to acknowledge receipt of the complaint in writing within five (5) business days (unless earlier resolved) and, after investigation, within 30 business days after receipt would be required to provide written notification to the borrower of resolution of the error (or an explanation of the servicer's conclusion that no error occurred). New rules would also (i) prohibit servicers from charging a fee for responding to any qualified written request and/or correcting an error; (ii) define what servicer's action or omission would constitute an error subject to the rule; and (iii) set out procedures for extension of the timing requirements when an investigation is being conducted. However, requirements for servicers to investigate and correct errors may not apply in certain instances in which the consumer's notice of error (i) is not timely asserted before a scheduled foreclosure, (ii) is duplicative of an earlier notice asserted and resolved by the servicer, (iii) is overbroad or unduly burdensome, or (iv) asserted more than one year after the mortgage loan was transferred to another servicer or the loan was paid in full.

- **Early Intervention for Delinquent Borrowers.** Servicers would be required to make a good faith effort to contact delinquent borrowers no later than 45 days after the onset of delinquency and to respond promptly to troubled borrowers who contact the servicers within five (5) business days. Among its obligations, servicers would have to provide the borrowers written information about (i) options to help avoid foreclosures, such as loss mitigation programs available to them, (ii) an explanation of the foreclosure process and possible foreclosure timelines, and (iii) contact information for housing counselors who may be able to assist the borrowers. If a borrower's payment is 30 days late, the servicer would be permitted to provide such notifications orally, but if 40 days late the servicers would be required to provide written notice containing certain specific information regarding the borrower's loss mitigation options. The proposed rule contains model language that servicers may use for these required notices.

- **Continuity of Contact for Delinquent Borrowers.** Servicers would be required to provide all borrowers who become 45 days delinquent (i.e., no later than five days after providing the early intervention notice) or who request assistance in avoiding foreclosure with direct and ongoing access to assigned personnel to assist them with loss mitigation options available. These employees would be required to have ready availability or access to (i) a complete record of the borrower's payment history, (ii) all previous communications between the servicer and the borrower and any authorized third parties, (iii) all borrower-submitted documentation, (iv) information on the status of any ongoing or pending foreclosure actions, and (v) underwriters with the ability to evaluate the borrower for loss mitigation options and to approve or recommend approval.

- **Loss mitigation procedures.** Servicers that offer loss mitigation options would be required to establish procedures to ensure that completed loss mitigation applications are evaluated before proceeding with a foreclosure sale. Loss mitigation applications would be required to be reviewed and the borrower notified within five days if the application is incomplete. Within 30 days after receiving a complete application, the servicer would have to provide a response. If the request for loss mitigation is denied, the borrower would have to be allowed at least 14 days to appeal the decision. Appeals would have to be decided within 30 days by different personnel than those who denied the initial application. The servicer would not be permitted to proceed with foreclosure unless (i) the servicer has denied the application and the time for the borrower to appeal has expired, (ii) the servicer has offered a loss mitigation option which was not accepted by the borrower within 14 days, or (iii) the borrower has failed to comply with the terms of a loss mitigation agreement.

Sources: Proposed Rule published September 17, 2012 at 77 F.R. 57200 – 57315 (Reg. X)
Proposed Rule published September 17, 2012 at 77 F.R. 57318 – 57406 (Reg. Z)

5. Rules Restricting Loan Originator Compensation, Loan Originator Qualification and Licensing, and Prohibitions of Certain Practices.

Statutory changes made by the Dodd Frank Act to Regulation Z's loan originator compensation provisions would be implemented by Proposed Rule published by the CFPB on September 7, 2012 at 77 F.R. 55272-55370. The CFPB intends to adopt a Final Rule by the spring of 2013 regulating certain mortgage loan origination compensation practices, including prohibiting mortgage loan originators ("MLOs") from receiving compensation from anyone other than the consumer based on the terms of the loan (other than the loan amount). The rule would also require that consumers be offered and receive fair and understandable mortgage loans that reasonably reflect their ability to repay. The rule would expand upon the Final Rule adopted by the Federal Reserve Board effective April 1, 2011 as Regulation Z, 12 CFR §1026.36 (the "FRB Loan Originator Rule") and in some cases include new or different requirements enacted by the Dodd-Frank Act (as well as certain qualification requirements under the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the "SAFE Act").

The Dodd-Frank Act mandates generally that MLOs can only be compensated by consumers, but provides an exception that allows MLOs to be compensated by other parties, such as a creditor or mortgage brokerage company, under two conditions:

1. The MLO in that case must not receive any compensation directly from the consumer; and
2. The consumer must not be charged or make an upfront payment of discount points, origination points, or origination fees (other than bona fide third-party fees that are passed through to the third-party and not retained by the creditor, the MLO, or an affiliate of either).

Accordingly, a creditor in a loan transaction may pay compensation to individual MLOs it employs as loan officers or to a mortgage brokerage company (including where the brokerage firm then pays its employee brokers) provided the consumer does not directly compensate those MLOs and does not pay origination points or fees. However, under the Dodd-Frank Act when the consumer pays the mortgage brokerage company, which in turn seeks to pay its employee MLO compensation tied to the transaction, the brokerage company under current rules is prohibited from compensating its MLO employee (other than by a salary or hourly wage) because the consumer's payment to the mortgage brokerage firm itself would constitute such a prohibited upfront payment.

Because enforcement of this prohibition would significantly disrupt industry compensation practices without apparent benefit to consumers and would force creditors to provide no-point, no-fee loans (and to recover their administrative costs through increased interest rates over time rather than through up-front fees), the CFPB is proposing to grant a partial exemption when the creditor compensates a MLO that would permit consumers to pay up-front points and fees in retail (i.e., direct lending) and wholesale (i.e., brokered lending) originations, under the following conditions:

(i) any discount points charged to the consumer must be bona fide discount points (meaning payment must result in at least a minimum reduction in the contract interest rate for each point paid); and

(ii) the creditor must also offer the borrower the availability of a comparable alternative loan with no upfront discount points, origination points, or origination fees that are retained by the creditor, broker, or an affiliate of either (called a "zero-zero alternative") unless the consumer is shown to be unlikely to qualify for such a zero-zero alternative.

The Proposed Rule would provide creditors with a *safe harbor* for compliance with this requirement if the creditor, when providing the consumer an individualized quote for a loan that includes upfront points and/or origination fees, also provides a quote for a zero-zero alternative (or, in transactions involving mortgage brokers, the creditor provides the mortgage brokers with the pricing for all of its zero-zero alternatives, which pricing is quoted by the brokers when presenting different loan options to consumers).

NOTE: The CFPB did not propose further consideration of imposing an additional condition announced earlier that any up-front origination fees paid by the consumer or up-front fees paid to an affiliate of the creditor or MLO would have to be a "flat fee" that does not vary with the size of the loan (with an exception of title insurance charges that would have been permitted to vary with the loan amount).

Other compensation practices under consideration include:

- *Profit Sharing Plans.* The CFPB is considering how the Dodd-Frank Act's compensation restrictions apply to qualified retirement plans, such as employer-paid 401(k) plans, and non-qualified plans, such as employer's bonus or profit-sharing plans, when the employer contributions are derived from company profits from mortgage loan origination business. The CFPB is considering allowing MLO employees to participate in such plans where the compensation is substantially deferred in time or there are other safeguards to the plans sufficient to mitigate steering incentives.

- *Pricing Concessions.* The FRB Loan Originator Rule does not allow creditors and mortgage brokerage companies to set a MLO's compensation at a certain level and then lower it in selective cases where different loan terms are negotiated (e.g., in order to match competitive offers) because such a practice could be used to circumvent the ban on compensation based upon loan terms or conditions. The CFPB is considering a proposal to allow MLOs to make certain types of pricing concessions to cover unanticipated increases in third-party closing costs that are outside the control of the MLO or the creditor or its affiliates and exceed amounts disclosed on the Good Faith Estimate.

- *Point Banks.* A so-called "point bank" is created by a creditor's allocations of points to particular MLOs for each transaction that the MLO closes. The MLO is then permitted to use these points to obtain pricing concessions from the creditor in future loan transactions. For example, the MLO may pay discount points to the creditor on behalf of the borrower from credits to its point bank account in order to obtain a lower interest rate for the borrower. But basing the points credited to the point bank on the difference in the par rate and actual rate of a transaction or variation in any other term of the loan, for example, is not permissible because such contributions would vary based on the terms of the loan. The CFPB is considering amending the regulation to clarify that point banks funded by the employer are permissible if (i) the creditor does not base the amount of the contribution to the point bank for any particular transaction on the terms or conditions of the transaction; (ii) the creditor does not change its contributions to the point bank over time based on terms or conditions of a MLO's transactions or on whether the MLO "overdraws" the MLO's point bank account; and (iii) if a MLO overdraws the MLO's point bank account on any transaction, the creditor does not reduce the MLO's commission on the transaction.

- *Proxies.* The prohibition against compensating MLOs based on the terms or conditions of a loan extends to factors that may serve as a "proxy" of a loan term or condition. For example, basing such compensation on a borrower's FICO credit score in a loan transaction would be deemed a proxy for the loan interest rate (because credit scores substantially correlate to interest rates charged). To clarify the rule, the CFPB is considering providing examples of particular factors that serve as proxies for loan terms and accordingly would be impermissible and setting forth a test to determine that a particular factor is deemed a proxy for a loan term if (i) it substantially correlates with a loan term; and (ii) the MLO has discretion to use the factor to propose terms of a loan to a consumer with more costly or less advantageous terms than that of another loan for which the consumer likely qualifies and is available through that MLO.

Creditors must maintain records of (i) compensation paid MLOs for each transaction and (ii) the compensation agreement in effect on the date the interest rate was set for each such transaction for a period of two years after the date of consummation of each transaction.

Source: Proposed Rule published September 7, 2012 at 77 F.R. 55272 — 55370

6. Rules Imposing Consumer Counseling and Terms Restrictions on High-Cost Loans.

The Dodd-Frank Act amended TILA by (i) expanding the types of mortgage loans that are subject to the protections of the Home Ownership and Equity Protection Act of 1994 (HOEPA), (ii) revising and expanding the triggers to HOEPA coverage, and (iii) imposing additional substantive restrictions on HOEPA mortgage loans, including a pre-loan counseling requirement. It also amended TILA and RESPA by imposing home ownership counseling requirements for consumers in certain circumstances.

Under the CFPB's Proposed Rule published August 15, 2012 to implement these Dodd-Frank Act provisions, most types of mortgage loans secured by a mortgage on a consumer's principal dwelling, including purchase-money mortgage loans, refinances, closed-end home equity loans, and open-end home equity lines of credit (HELOCs) would be subject to HOEPA coverage. Loans would be covered by HOEPA protections (i) if the APR exceeds the average prime offer rate (APOR) by 6.5 percentage points for most first-lien loans and 8.5 percentage points for subordinate lien loans; (ii) if the points and fees exceed 5% of the total loan amount (or a higher threshold for small loans below $20,000); or(iii) if the creditor charges a prepayment penalty for a period longer than 3 years after loan closing or penalties of more than 2% of the amount prepaid.

Under the Proposed Rule certain new or expanded restrictions would be imposed on loans covered by HOEPA:

- Balloon payments and prepayment penalties would be prohibited;
- Late fees would be restricted to 4% of past due payment;
- Fees for loan modification or deferral would be prohibited and fees for providing a payoff statement would be restricted;
- 'Ability to repay' a loan would have to be assessed for all high-cost closed- and open-end loans, including open-end credit plans; and
- Borrowers would be required to receive counseling on the advisability of the loan from a federal certified or approved home ownership counselor.

Moreover, creditors would be required to provide applicants for *any* home mortgage loan (i.e., not just HOEPA loans) a list of federally certified or approved homeownership counselors or organizations within three business days after application. First-time homeowners would also be required to receive home ownership counseling if applying for any loan with a negative amortization feature.

Source: Proposed Rule published August 15, 2012 at 77 F.R. 49090 – 49166

7. Rules Establishing Appraisal Standards and Requirements for Higher Risk Loans and Requirement that Creditors Provide Free Copies of all Written Appraisals Made in Connection with Applications for any Home Loan.

The CFPB published a Proposed Rule on September 5, 2012 at 77 F.R. 54722 — 54775 to implement new TILA Section 129H regarding appraisal requirements for "higher-risk loans" enacted by the Dodd-Frank Act. The rule when adopted in final form will establish appraisal requirements for higher-risk loans and set minimum requirements for state registration of appraisal management companies (AMCs) and automated valuation models. The rule is expected to augment the Final Rule on Valuation Independence adopted by the Federal Reserve Board effective April 1, 2011 (Regulation Z, 12 CFR §1026.42) and, consistent with the Dodd-Frank Act provisions, the rule would permit a creditor to make a higher-risk mortgage loan only if:

- The creditor obtains a written appraisal performed by a certified or licensed appraiser;
- The appraiser conducts a physical inspection of the property and the interior of structures on the property;
- At application or within three business days after application, the loan applicant is provided a statement regarding the purpose of the appraisal and notification that (i) the creditor will provide the applicant a copy of any such written appraisal, and that (ii) the

applicant may choose to have a separate appraisal conducted at applicant's own expense; and

- The creditor provides the applicant with a free copy of any such written appraisal(s) within 30 days after receipt, but not later than three business days before closing.

Moreover, a creditor of a higher-risk mortgage loan would be required to obtain an addition written appraisal from a different qualified appraiser at no cost to the applicant when the loan is intended to finance the acquisition of the applicant's principal dwelling and (i) the seller has owned the property for only 180 days or less (measured to the date of the applicant's purchase agreement) and (ii) the applicant is paying a higher price than the seller paid. This additional written appraisal would be required to include an analysis of the difference in the price originally paid by the seller to acquire the property and the sales price to be paid by the loan applicant under the purchase agreement, including any changes in market conditions and any improvements that may have been made to the property during this period.

A higher-risk mortgage loan subject to these regulations would be defined as a closed-end consumer credit transaction secured by a principal dwelling with an annual percentage rate (APR) exceeding certain statutory thresholds, substantially similar to the current rate triggers for so-called "HOEPA" higher-priced loans. Reverse mortgages and certain loans secured solely by mobile homes would be exempted. The index for determining if a loan is a higher-risk mortgage loan would be the "average prime offer rate (APOR)," which is a published rate derived from average interest rates, points, and other loan pricing terms currently being offered to consumers by a representative sample of creditors for loans that have "low-risk pricing characteristics." Loans would be considered higher-risk mortgage loans if the APR exceeds the APOR by 1.5% for first-lien loans, 2.5% for first-lien jumbo loans, and 3.5% for subordinate-lien loans.

However, the CFPB acknowledges that if, as proposed, it decides to re-define the Finance Charge and APR to include in its calculation so-called 4(c)(7) real estate related charges and other charges which are currently excluded, the number of loans classified as higher-risk mortgage loans subject to these regulations could substantially increase. To avoid that result, the CFPB is instead considering using as a index a "transaction coverage rate (TCR)," which would be defined to be essentially the APR as adjusted to also include just those charges retained by the creditor, a mortgage broker, or an affiliate of either.

Additionally, the CFPB published a Proposed Rule on August 21, 2012 to implement §701(e) of the Equal Credit Opportunity Act (ECOA), as amended by the Dodd-Frank Act, to require that creditors (i) provide applicants for all loans secured by a first lien on a dwelling with a free copy of written appraisals and valuations developed in connection with their applications and (ii) notify loan applicants in writing of their right to receive such a copy at no additional cost. The rule when adopted in its final form would revise §1002.14 of Regulation B to the Equal Credit Opportunity Act to require that a creditor must provide an applicant with a written disclosure of the applicant's right to receive a copy of all written appraisals and valuations in connection with the loan application within three business days after application and thereafter that the creditor must provide a copy of any such appraisal or valuation promptly (generally within 30 days of receipt by the creditor) and in any case not later than three business days prior to loan closing (unless the applicant has waived his right to an advance copy and agreed to receive the copy at loan closing). A creditor may require the applicant to pay a reasonable fee to reimburse the creditor for the cost of the appraisal or valuation but may not separately charge the applicant for providing a copy of the appraisal or valuation.

Sources: Proposed Rule published September 5, 2012 at 77 F.R. 54722 — 54775
Proposed Rule published August 21, 2012 at 77 F.R. 50390

CAVEAT: Proposed Rules are subject to public comment and further consideration by the regulatory authority before adoption of Final Rules. Administrative rulemaking is a fluid process and Final Rules may differ substantially from the Proposed Rules outlined in this memorandum. This memorandum is provided for your general information only and is not intended as specific legal advice. You should not place reliance on this general information alone but should consult counsel regarding the application of the laws and regulations discussed in this memorandum to your specific case or circumstances.