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: J. Alton Alsup

DATE: May 7, 2012

SUBJECT: Dodd-Frank Act Mandates a Mound of New Mortgage Regulations Over the Next 12-24 Months.

In July, 2010, Congress passed the landmark Dodd-Frank Reform and Consumer Protection Act (the "Dodd-Frank Act"), which in part enacted broad scale consumer finance reform measures and created the new Consumer Financial Protection Bureau (the "Bureau") to act as regulator. On July 21, 2011, all regulatory rulemaking and enforcement authority for mortgage finance regulations was transferred from the Federal Reserve, HUD, and other federal regulatory agencies to the new Bureau, including in particular 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 the numerous other federal statutes affecting home mortgage lending in some manner. The Dodd Frank Act requires the Bureau to adopt a number of new mortgage regulations with specific deadlines over the next 12 – 24 months. Some of the regulations the Bureau has under study and is currently considering are outlined here:

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

By July, 2012, the Bureau must propose new rules and forms combining truth-in-lending consumer disclosures required under TILA with the Good Faith Estimate (GFE) and HUD-1 settlement statement required under RESPA. The new rule and forms would apply only to closed-end credit transactions (i.e., HELOCs and reverse mortgages would be exempted). The proposals under consideration by the Bureau 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 shortly after loan application. Prototype forms have been designed and are undergoing consumer testing.

- **New Form of Settlement Disclosure.** The HUD-1 and the Final TIL would be replaced and combined into a single, new form to be known as the "Settlement Disclosure." The Settlement Disclosure would summarize final loan terms and costs and provide a detailed accounting of the transaction. Prototype forms have been designed and are undergoing consumer testing.

- **Issuance and Reissuance of Settlement Disclosure.** The Settlement Disclosure would be provided at or prior to closing and the Bureau is considering requiring that the disclosure be provided to consumers three (3) days prior to closing (although some common adjustments outside the lender's control such as recording fees may be allowed to be changed). Reissuance of the Settlement Disclosure and an additional three- day waiting period would be required only if during the three days after issuance of the Settlement Disclosure (i) the APR in the Settlement Statement 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 Settlement Disclosure increases beyond a specific tolerance (in amount yet to be determined).

- **Responsibility for Providing Settlement Disclosure.** The Bureau is considering alternative rules for assigning responsibility for preparation and delivery of the Settlement Statement to the consumer three days before closing. Alternative No. 1 would make the lender solely responsible for preparing and delivering the Settlement Statement to the consumer. Alternative No. 2 would make the lender and settlement agent jointly responsible, with the lender having to provide the TILA-related information and the settlement agent having to provide the RESPA-related information

- **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).

- **Restrictions on Lender's Charging 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 costs of service providers owned or affiliated with the lender and to 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.

- **Lender's Required Records Retention.** Lenders would be required to maintain standardized, machine-readable, electronic versions of the Loan Estimate and Settlement 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 Bureau 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 a 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 APR, which is the Finance Charge expressed as a yearly rate. The Finance Charge is mostly 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 transaction such as costs and fees for credit reports, appraisal, survey, title insurance, and document preparation services. The Bureau is considering removing many or all of these exclusions to provide a simpler and more uniform calculation of the APR and better allow the consumer to compare the total cost of one loan to another.

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

By January, 2013, the Bureau must adopt a Final Rule requiring lenders to determine that a consumer has the ability to repay a home mortgage loan and must establish standards for lender compliance, such as by the making of a "Qualified Mortgage." 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, which rule now applies 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 (76 FR 27390) 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. The Bureau must now publish a Final Rule implementing the Dodd-Frank Act statutory changes and establish standards for complying with "ability to repay" requirements.

The Bureau is considering a general standard under which a lender could comply with the "ability to repay" requirement if it 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 Bureau is considering whether a qualified mortgage should provide a creditor a *safe harbor* from liability or instead merely 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 or assets are verified and documented;
- 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.

3. New Rules and Forms for Mortgage Servicing Requirements.

By January, 2013, the Bureau must adopt a Final Rule implementing the Dodd-Frank Act mandates for consumer protections in the servicing of their 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 for responses that 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. These new statutory requirements will take effect automatically in January, 2013, just as written in the statute, unless the Bureau issues a Final Rule prior to that time or issues a rule extending that effective date to a date no later than January 21, 2014.

- **ARM Reset Notice.** A written notice would be required to be provided borrowers with hybrid ARM loans at least six (6) months prior to the initial reset of the interest rate for closed-end credit transactions secured by a consumer's principal residence. The timeframe and content of periodic ARM adjustment notices required under current regulations would also be amended.

- **Periodic Loan Statements.** Periodic statements would be required to be provided 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).

- **Force Placed Insurance Notices.** Two successive notices would be required to be sent to borrowers with lapsing or lapsed property insurance policies alerting them that the servicer is obtaining force-placed insurance policies. New regulatory requirements and procedures will 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.

- **Prompt Crediting of Payments.** Servicers will be required to credit scheduled borrowers' payments as of the date received in connection with consumer credit secured by the consumer's principal dwelling (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. Servicers, however, 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 earliest delinquent payment 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 for 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 what error the borrower believes has occurred and when), 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.

- **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.

- **Continuity of Contact for Delinquent Borrowers.** Servicers would be required to provide all borrowers who become 45 days delinquent or who request assistance in avoiding foreclosure with direct and ongoing access to a staff of the servicer's customer service employees dedicated to that purpose. These employees would be required to have ready access to a complete record of the borrower's payment history, all previous communications between the servicer and the borrower and any authorized third parties, all borrower-submitted documentation, information on the status of any ongoing or pending foreclosure actions, and availability to underwriters

with the ability to evaluate the borrower for loss mitigation options and to approve or recommend approval.

4. Other Significant Bureau Rules in the Making.

- **Loan Originator Compensation.** By January, 2013, the Bureau must adopt a Final Rule prohibiting mortgage loan originators from receiving compensation from anyone other than the consumer based on the terms of the loan (other than the loan amount). The rule must also ensure that consumers are offered and receive fair and understandable mortgage loans that reasonably reflect their ability to repay. The rule is expected to be substantially similar to the Final Rule adopted by the Federal Reserve Board effective April 1, 2011 (Regulation Z, 12 CFR §1026.36).

- **Appraisal Independence.** By January, 2013, the Bureau must adopt a Final Rule establishing appraisal requirements for higher-risk loans and setting minimum requirements for state registration of appraisal management companies (AMCs). 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)