

An Analysis of the Mortgage Reform and Anti-Predatory Lending Act Provisions of Dodd-Frank

August 9, 2010

Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Bill") is The Mortgage Reform and Anti-Predatory Lending Act ("MRAPLA"), which was added to the legislation while it was being reviewed by the House of Representatives. As a result, this 200-plus page addition to the 11 page Truth in Lending Law was not subject to the same kind of scrutiny as the rest of Dodd-Frank and will certainly increase lender caution before making, selling and securitizing mortgage loans, which is not likely to help the moribund housing industry. Because of the impact that MRAPLA will likely have on both the banking and housing industry, this article will analyze its provisions.

MRAPLA requires lenders to determine "in good faith and document that the buyer has a reasonable ability to repay the loan." The law also requires that "consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive." Of course, there is no definition of "unfair, deceptive or abusive" so that will be left for a judge to determine, but that will be easier to figure out than the lender's ability to determine if a borrower can reasonably repay the loan.

The Bill also contains a prohibition on steering, which provides that the mortgage originator can only receive a fee from the borrower or the lender, but not both and only if the borrower does not make an upfront payment of discount points, origination points or fees regardless of how they are denominated. This will also require a great deal of monitoring and, no doubt, a significant number of regulations.

References throughout Title XIV to the "Board" refer to the Federal Reserve Board, which is required to issue regulations that prohibit or condition acts which the Board "finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers." This provides the Board with a great deal of discretion in determining what may be "unfair" and what is "necessary or proper," but it will also make even the most cautious lender wary of being able to satisfy these requirements.

Section 1411 is the "Ability to Repay" section of Subtitle B, the "Minimum Standards for Mortgages" provisions, which precludes any creditor from making a residential loan unless the creditor "makes a good faith determination based on verified and documented information that, at the

time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance ...and assessments." In order to sell or securitize a mortgage loan, the seller of the loan may have to provide a representation as to the determination in the preceding sentence. This provision not only provides a defaulting borrower with a clearly marked escape route, but also raises questions as to how the lender will make credit available under The Community Reinvestment Act while still complying with MRAPLA. In addition, if the property is going to be encumbered by more than a single mortgage, this provision requires the creditor to determine whether the consumer can pay all of its mortgage loans.

The creditor is not only required to make a determination as to the consumer's current income but the "expected income the consumer is reasonably assured of receiving," which might mean that those on commission or who get large discretionary bonuses might not be able to obtain financing. The statute, not unreasonably, requires a creditor to verify the consumer's income and assets, which should end the NIV loans and Alt A loans that became so prevalent during the real estate bubble. However, creditors are also required to "safeguard against fraudulent reporting" by use of the Internal Revenue transcripts of tax returns or another method that quickly and effectively verifies income. The verification process can be streamlined for refinancing of loans made, guaranteed or insured by federal departments or agencies as long as the consumer is not more than 30 days past due on the existing mortgage, the refinancing does not increase the outstanding principal balance and the total points and fees do not exceed 3% of the total new loan amount, the interest rate is lower and the loan self amortizes.

The law introduces the concept of a "Qualified Mortgage", which is a mortgage a) that does not have negative amortization or a balloon payment, b) where the borrower's income and financial resources are verified and documented, c) where the mortgage complies with the guidelines or regulations established by the Board relating to ratios of total monthly debt to monthly income, d) where total points do not exceed 3 percent, e) where the term of the loan does not exceed 30 years, but could include a balloon loan, if the Board establishes regulations. A creditor and an assignee of a Qualified Mortgage may presume that the loan has met the "Ability to Repay Requirements."

Section 1413 of the Act is entitled Defenses to Foreclosure and provides that if the creditor, assignee or other holder of a residential mortgage commences a foreclosure, a consumer may assert a violation by the creditor as a matter of defense by recoupment or set off without regard to the statute of limitations. This will leave lenders exposed to every kind of defense imaginable even if the foreclosure occurred a decade earlier.

Section 1414 prohibits prepayment penalties if the loan is not a Qualified Mortgage. Moreover, a Qualified Mortgage may not contain a prepayment penalty of more than 3% during the first year, 2% during the second year, or 1% during the third year, after which no prepayment penalty may be charged. The Act also requires that creditors cannot merely offer a consumer a product with a prepayment penalty. The creditor must offer a product without a prepayment penalty and, although not explicitly stated, it seems likely that the Board will require that the two products be comparable. However, what happens if there are no comparable products? Would a loan that is freely prepayable but that carries a higher interest rate be considered comparable?

The Act also prohibits any creditor from financing any credit life, credit disability, credit unemployment or credit property insurance for any debt cancellation or suspension agreement or contract through insurance that is payable monthly. No residential mortgage or extension of credit secured by a principal dwelling may require arbitration or any other nonjudicial procedure to resolve any controversy or settle any claims, although the consumer can agree to arbitrate a dispute after it actually arises. In addition, no provision of any residential mortgage shall be applied or interpreted to bar a consumer from bringing an action in the United States district court or any other court of competent jurisdiction.

Many states have anti-deficiency laws in which the borrower cannot be sued for the difference between the amount borrowed and the amount of the sales proceeds from a foreclosure auction. The Act contains a provision requiring that creditors and mortgage originators in those states must give consumers written notice of the anti-deficiency laws and the significance of such laws before the loan closes. Moreover, in states with anti-deficiency laws, the borrower must be given written notice prior to the closing of any provision in the loan documents that would cause the borrower to lose the protection of such laws.

Section 1417 provides that no creditor or assignee shall be liable to an obligor if such obligor or co-obligor is convicted of obtaining such residential mortgage loan by deception.

Section 1418 mandates that, at least six months before the reset date of any adjustable rate mortgage, the creditor or servicer must provide separate written notice to the consumer of any formula used in making the adjustment, an explanation of how the new interest rate and payment will be determined, a good faith estimate of the new payment, a list of alternatives available to the consumer including refinancing, renegotiation of loan terms, payment forbearance and pre-foreclosure sales and the names, addresses and telephone numbers of credit counseling services and the state housing finance authority. This leaves the creditor and

servicer exposed to litigation or regulatory complaints if their estimates of the market six months later turn out to not be accurate.

Section 1420 requires that every monthly mortgage statement contain the following information: the amount of the outstanding principal balance, the current interest rate, the date when the interest rate will adjust, the amount of any prepayment fee to be charged, a description of any late payment fees, a telephone number and email address for the obligor to obtain additional information, the names, addresses, telephone numbers and email addresses of counseling agencies and such other information as the Board may prescribe.

Subtitle C deals with High Cost Mortgages, which are defined as a consumer credit transaction that is secured by the consumer's principal residence and, a) if a first mortgage on the consumer's home, the amount borrowed is less than \$50,000 and the interest rate is more than 6.5% above the prime offer rate or more than 8.5% over the prime offer rate if the dwelling is personal property (e.g., a mobile home), or b) if it is a subordinate or junior mortgage and the interest rate will exceed 8.5% over the prime offer rate or the total points and fees exceed 5% for loans over \$20,000 or 8% for loans under \$20,000 or c) a prepayment penalty can be charged more than 36 months after the closing or d) exceed 2% of the amount prepaid. The problem with these provisions is that they are so detailed that they fail to account for future changes in the market. Therefore, what is considered an appropriate percentage and base in 2010 may be absurd in 2020 or, for that matter, even in 2011. This could create another freeze in lending and cause another collapse if Congress fails to build flexibility into the law.

Section 1432 precludes any High Cost mortgage from containing a payment that is more than twice as large as the average payment made during the term. What this means is that if interest rates fluctuate or credit is less available, borrowers will be stuck because if the only mortgage available has higher interest than Congress deemed in 2010, than the mortgage cannot be refinanced. This could also refer to a cap on the payments under an adjustable rate loan.

Section 1433 forbids any creditor from recommending or encouraging default on an existing loan or other debt prior to or in connection with the closing of a High Cost Mortgage that refinances all or a portion of the existing debt. In addition, no creditor can impose a late payment charge or fee in connection with a High Cost Mortgage in excess of 4% of the amount due, unless the loan specifically authorizes it within 15 days after the due date. No High Cost Mortgage may provide the creditor with the right to accelerate the indebtedness except for a payment default, violation of the due on sale provision or pursuant to a material violation of a

provision unrelated to payment. No creditor can finance the prepayment fees or penalty in a refinancing or any points or fees for a High Cost Mortgage. A creditor may not take any action in connection with a High Cost Mortgage to structure a loan transaction to evade the provisions of the Act or to divide the loan into separate parts. In addition, no creditor or servicer can charge a fee for transmitting a pay-off statement.

Moreover, no creditor can extend credit under a High Cost Mortgage without first receiving certification from a counselor approved by HUD that the consumer received counseling on the advisability of the mortgage. This will result in even more regulations and more documents that the lender and the purchaser of the loans will have to review, thereby further restricting the resurgence of the secondary mortgage market.

Subtitle D creates the Office of Housing Counseling, which requires the establishment of counseling programs and requires HUD to take actions to advise home buyers of the availability and importance of obtaining an independent home inspection. It also requires that homeowners be advised of foreclosure rescue scams.

Subtitle E provides for Mortgage Servicing and includes, as does section 1461, a requirement that creditors establish an escrow or impound account for the payment of taxes and hazard insurance and, if applicable, flood insurance, mortgage insurance, ground rent and any other periodic payment if it is required by federal or state law or the loan is made, guaranteed or insured by a state or federal agency, and the transaction is secured by a first mortgage or lien on the consumer's principal dwelling having an original principal amount that does not exceed the amount of the maximum limitation on the original principal obligation of the mortgage. In the event that the consumer waives the escrow requirement, the consumer must be given written notice of the consumer's responsibilities and the implications of the consumer's failure to make the required payments.

Section 1463 amends section 6 of the Real Estate Settlement Procedures Act of 1974 and requires that the servicer of a federally insured mortgage shall not obtain hazard insurance on the borrower's behalf (*i.e.*, force-placed insurance) unless there is a reasonable basis to believe that the borrower failed to comply with the loan provisions requiring the borrower to maintain property insurance. In addition, the servicer cannot charge fees for responding to valid written requests, or fail to timely respond to borrower's requests, fail to respond within 10 business days to requests from borrowers for the name and address of the owner or assignee of the loan. Moreover, the servicer may not impose a charge on borrowers for force-placed insurance unless the servicer has a) written to the borrower reminding the borrower of his or her obligation to obtain the insurance and

requesting evidence of the insurance and b) the servicer has sent a second notice 30 days later. The servicer is required to accept any reasonable form of written confirmation from the borrower of existing insurance containing the policy number and the identity of the insurance company. Within 15 days of receiving evidence of the borrower's insurance, the service must cancel the force-placed insurance and refund to the borrower all forced-placed insurance premiums paid by the borrower and any related fees. This means that the creditor has to pay the cost of the borrower's insurance if the borrower fails to obtain it on time, and the creditor, in order to protect its collateral, obtains force-placed insurance, but the borrower then obtains the insurance.

Section 1464 requires that no servicer shall fail to credit a payment to the consumer's loan account as of the date of receipt and shall send a payoff letter including information on the borrower's escrow account within 7 business days of receiving the request for such a letter.

Section 1471 precludes any creditor from making a higher risk mortgage without first obtaining a written appraisal of the property including the interior of the property, which requires a physical property visit by a certified or licensed appraiser. In the event that the purchaser is seeking financing within 180 days of acquiring the property, a second appraisal, from a different certified or licensed appraiser, is required, the cost of the second appraisal cannot be charged to the applicant. A higher risk mortgage is defined as a residential mortgage loan secured by a principal residence that is not a qualified mortgage with an annual percentage rate that exceeds the prime offer rate for a comparable transaction by 1.5% if a first lien mortgage that does not exceed the amount of the existing mortgage, by 2.5% if a first lien mortgage that exceeds the original principal obligation, by 3.5% or more for a subordinate mortgage. This is another example of Congress in 2010 stipulating what is an appropriate interest rate at any point in the future without regard to inflation, deflation, the market or any other unforeseen consequences.

Section 1472 requires that the appraisers must be independent and, if the lender believes that the appraiser is violating any standards, the lender must refer the matter to the state licensing agency. Moreover, a creditor cannot extend credit based on an appraisal which the lender knows is in violation of these standards. Lenders are also required to compensate appraisers at a rate that is customary and reasonable in the market area of the property. Sections 1473 and 1474 are appraisal company requirements and 1475 contains standards for automated valuation models used to estimate collateral value. In addition, broker price opinions may not be used as the primary basis to determine the value of property.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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Subtitle G deals with Mortgage Resolution and Modifications and section 1481 requires HUD to develop a program to insure the protection of current and future tenants and at-risk multi-family properties. Section 1482 requires each mortgage servicer to provide each borrower whose request for a mortgage was denied with all borrower-related and mortgage-related input data used in any net present value analyses used for the property.

Subtitle H are Miscellaneous Provisions and contains section 1491, relating to Government Sponsored Enterprises and provides that "the hybrid public-private status of Fannie Mae and Freddie Mac is untenable and must be resolved to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive." The Act also provides that "it is the sense of Congress that efforts to enhance by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit would be incomplete without enactment of meaningful structural reforms of Fannie Mae and Freddie Mac."

Section 1492 requires a study be prepared on government efforts to combat mortgage foreclosure rescue scams and loan modification fraud. Section 1494 requires HUD to conduct a study on foreclosures resulting from the use of Chinese drywall. Section 1497 provides \$1 billion for the redevelopment of abandoned and foreclosed homes. Section 1498 requires that HUD establish a program for making grants to provide a full range of foreclosure legal assistance to low and moderate income homeowners and tenants.

There is little doubt that borrowers, particularly of subprime mortgages, needed additional protection, but MRAPLA will reduce the likelihood that the housing industry will recover in the near future and that it will have an adverse impact on the health of the lending institutions, which are holding mortgages worth trillions of dollars. Real estate in general and housing in particular is an illiquid investment and it is only credit that makes the system work, but MRAPLA will reduce the availability of credit.

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