FROM BUTLER, SNOW, O'MARA, STEVENS & CANNADA, PLLC

QUARTERLY REPORT

MISSISSIPPI REGULATORY COMPLIANCE GROUP

February 2013 Vol. 24 No. 1

THE ABILITY-TO-PAY AND QUALIFIED MORTGAGE RULE: THE CONCURRENT PROPOSAL

On January 10, 2013, the CFPB issued its concurrent rule setting forth the Ability-to-Pay provisions contained in the Dodd-Frank Act and the Qualified Mortgage Rule which provides certain possible protections for lenders from the possible liabilities they might encounter if they fail to satisfy the Ability-to-Pay requirements.

Many observers feel that the potential for significant liability under the Ability-to-Pay Rule will cause lenders to only originate Qualified Mortgages, and that the requirements and limitations of a Qualified Mortgage will significantly reshape residential mortgage lending for all banks.

As you know, the Federal Reserve Board adopted a Rule in 2008 which imposed an ability to repay requirement on all loans that were classified as "higher-priced mortgage loans." The Dodd-Frank Act significantly expanded the universe of loans now covered by this Rule. Now, the Ability-to-Pay Rule applies to any consumer credit transaction secured by a dwelling, except for HELOC's, time-share plans, reverse mortgages and temporary or bridge loans.

The Final Rule provides that a creditor is prohibited from making a covered mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer will have a reasonable ability to repay the loan, including any mortgage-related obligations such as taxes and insurance.

Although the Final Rule states that no attempt is being made to provide comprehensive underwriting standards to which creditors must adhere, it does provide that at a minimum the creditor must consider and verify each of the following:

- Current or reasonably expected income or assets;
- Current employment status;
- The monthly payments on the current transaction;
- The monthly payment on any simultaneous loan;
  The monthly payment for mortgage-related obligations;
- Current debt obligations;
- The monthly debt-to-income ratio or residual income; and
- Credit history.

The Ability-to-Pay and Qualified Mortgage Rule: The Concurrent Proposal 1
CFPB Issues Final Mortgage Servicing Rules 4
Final Rules on Mortgage Loan Originator Compensation and Qualifications 11
CFPB Announces New HOEPA Rules 16
CFPB Issues Final Rule for Escrow Accounts 18
Remittance Transfer Update 18
Why Banks Need the CFPB 19
CFPB Issues Rules on Appraisals For Higher Priced Mortgage Loans 20
CFPB Publishes New Rules on Disclosure and Delivery for Copies of Appraisals 21
MRCG Meeting - February 21, 2013 22
MRCG Compliance Calendar 23

It bears repeating that these items related to an applicant's ability-to-pay need to be both verified, using reliable third-party records, and documented. The CFPB's Final Rule provides special rules for verification of income and assets.

The Final Rule provides a "safe harbor" for loans that satisfy the definition of a Qualified Mortgage and that are not "higher-priced" mortgages (i.e., the APR does not exceed the Average Prime Offer Rate (APOR) plus 1.5% for first-lien loans or 3.5% for subordinate-lien).

Qualified mortgage loans that are higher-priced receive only a presumption of compliance, meaning the borrower can challenge whether or not the bank actually made a proper determination that the borrower did, in fact, have the ability to repay the loan that was obtained.

It helps to think of a Qualified Mortgage definition as having three parts: (1) the product features and points and fees charged which determine if the loan is a higher-priced loan or not; (2) the eight (8) underwriting requirements listed above; and (3) a determination of whether the consumer has a "back-end" debt-to-income ratio that is less than or equal to 43%. (Appendix Q of Regulation Z will provide methods for calculating debt-to-income.)

Then, there are two other possible ways for certain creditors to originate Qualified Mortgage's. The first is to originate mortgage loans that meet the statutory limits on product features, points, fees and certain other requirements to be eligible for purchase, guarantee or insurance by government-sponsored agencies (GSE's) such as Fannie Mae or Freddie Mac.

The second possibility is for a bank fall into the specially created category of small banks that operate predominantly in rural or underserved areas. For this unique (and very limited) group of banks, it will be possible to originate a Qualified Mortgage that satisfies all of the Qualified Mortgage requirements, but still can feature a "balloon payment." (remember: the Dodd-Frank Act prohibits a balloon-payment mortgage loan from being a Qualified Mortgage, with this one limited exception.)

For many years, community banks, and many others, have used balloon payment loans as a method for keeping interest rate risks under control without the complexity of originating adjustable rate mortgage loans. If your bank does not qualify for this limited exception (explained more fully below), it will have to significantly adjust its dwelling-secured mortgage lending practices if it wants to originate Qualified Mortgages and receive either safe-harbor treatment or the benefit of at least a presumption of compliance with the Ability-to-Pay Rule. One of your first steps should be to ask yourself whether your bank will meet the following requirements.

To qualify for this limited exception a creditor must:

- Have assets of no more than $2 billion;
- Operate predominantly in "rural" or "underserved" areas;
- Have total annual residential mortgage loan originations that do not exceed 500 in number;
- Make at least 50% of its first-lien loans (included within the 500 loan limit) in "rural" or "underserved" Counties;
- Retain these balloon-payment loans in the bank's loan portfolio.

The Final Rule tells us that a county is considered to be "rural" if it is not a Metropolitan Statistical Area (MSA) or a "Micropolitan Statistical Area" (one that is located adjacent to an MSA.) Furthermore, a County is considered "underserved" if no more than two creditors extend covered loans 5 or more times in that County during a calendar year. The CFPB will publish a listing of the counties within states that meet these requirements.

The first thing you should realize is that this is an "either/or" requirement. The counties in question must be either "rural" or "underserved" (of course both would be even better). We don't know for

certain, but this seems to be an exception with little or no application. How many banks operate predominantly in rural or underserved areas? How many originate fewer than 500 covered transactions (i.e., both first-lien and subordinate-lien loans)? And how many banks will have more than 50% of their first-lien covered loans secured by properties located in "rural" or "underserved" counties? Even if you think your bank might qualify, how close are you today to exceeding one or more of those limits? What will be the cost in time and expense required to monitor compliance with these limits? The CFPB explains that it recognizes the unique nature of smaller community banks, but one has to wonder if it really thought this one through. Banks in other parts of the country where counties are vast and populations are sparse, may see some relief, but banks in almost all other regions may see little relief when it comes to originating balloon loans as Qualified Mortgages.

But do give the CFPB some modicum of credit for at least trying to do some things to help community banks. Along with the Final Rule (discussed above) the CFPB has attempted to give some additional relief to small creditors. For instance, the Final Rule exempts banks with less than $2 billion in assets that operate in rural or underserved areas and make 500 or fewer first-lien mortgage loans per year, from the escrow account requirement that currently applies to higher-priced mortgage loans. (But remember that this exemption is so limited that it may not provide any real relief.)

The CFPB has also proposed a change to its Qualified Mortgage Rule that, if adopted, would raise the interest rate threshold for higher-priced, first-lien loans from 1.5% to 3.5% above the APOR. That change, again if adopted, would have the effect of extending the Qualified Mortgage safe harbor to certain higher-priced first-lien Qualified Mortgages made and held in portfolio by certain small creditors. Remember, however, that both of these changes are subject to the small creditor, rural or underserved area and number of loan restrictions that will make these attempts to help community banks possibly of little or no effect.

Finally, the CFPB included a proposal to add a fourth category of Qualified Mortgage which would include loans originated and held in portfolio by certain small creditors. This proposal would be similar in some ways to the provisions allowing small creditors to make balloon loans in rural or underserved areas. This additional proposed category of Qualified Mortgage, however, would differ in three ways: (1) the small creditor would not be required to operate in a rural or underserved area; (2) the portfolio loans could not feature a balloon-payment; and (3) while the creditor would still have to consider the consumer's debt-to-income ratio or residual income, the creditor would not be limited by the calculations in Appendix Q of Regulation Z, and the consumer's debt-to-income ratio could exceed 43% if justified in the creditor's considered opinion.

Since comments are solicited, small community banks would be wise to let their thoughts be known. The CFPB is right -- safe harbor protections are needed. The agency has correctly determined that exemptions from certain regulatory requirements are needed; however, they have completely misjudged whether these proposed measures will apply to many, or any, community banks because of the very limited number of banks that can meet these requirements. The proposal to eliminate the requirements related to rural and underserved counties should be adopted. Balloon-payment loans should be permitted for all banks meeting the asset size and number of transactions tests. If you wish to comment, those comments should be prepared and submitted promptly.

At our February Quarterly Meeting, we will have an extended discussion of both the Ability-to-Pay and Qualified Mortgage Rules, as well as their anticipated impact on a bank's dwelling-secured loans.

<Ed Wilmesherr>

CFPB ISSUES FINAL MORTGAGE SERVICING RULES

On January 17, 2013, the Consumer Financial Protection Bureau (CFPB) issued final rules to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) relating to mortgage loan servicing. In the wake of the financial crisis, Dodd-Frank imposed new requirements on servicers and gave the CFPB the authority to both implement the new requirements and also to adopt additional rules to protect consumers. The CFPB's stated purpose is to improve the information consumers receive from their servicers, enhance the protections available to consumers to address servicer errors, and establish baseline servicing requirements to provide additional protections for consumers who have fallen behind on their mortgage payments. The rules will take effect on January 10, 2014.

The rules amend both Regulation X (RESPA) and Regulation Z (Truth in Lending). Regulation X is amended and re-organized into three subparts: Subpart A covering settlement costs and disclosures, Subpart B covering escrows, and Subpart C covering mortgage servicing. The amendments to Reg. Z cover servicing related issues such as initial rate adjustment notices for ARM loans, periodic statements, prompt crediting of payments, and responses to payoff requests. The Reg. Z rules generally apply to any dwelling secured closed-end consumer credit transaction. Most of the Reg. X servicing requirements apply to any "federally related mortgage loan" subject, however, to the existing exemptions from coverage under RESPA and excluding HELOCs. However, the requirements for early intervention, continuity of contact and loss mitigation procedures for delinquent borrowers apply only to loans secured by the borrower's principal dwelling.

The final rules also include several exemptions and exceptions from some requirements for small servicers, defined as servicers that service 5,000 or fewer mortgage loans and service only mortgage loans that they or an affiliate originated or own. This should help to reduce the burden somewhat for most community banks servicing their own mortgages. Taken together, the final rules cover nine major topics, summarized below.

Periodic billing statements. Under Reg. Z, as amended, servicers (which may include creditors and assignees) must provide a periodic statement for each billing cycle containing information on: payments currently due (including due date, the amount of any late charge and the date it will be imposed if payment is not received, the amount due, and a breakdown of the payment as to principal, interest, escrow, fees and any past due amount); payments previously made (including the amount of payments received since the last statement along with a breakdown of how the payment was applied and the total of payments received since the beginning of the calendar year along with a breakdown showing how that total was applied); transaction activity (any debits or credits to the account during the statement period including date, brief description and amount); an explanation of any partial payments held in suspense or unapplied and what must be done for the funds to be applied; account information (including principal balance, current interest rate, next interest rate change date, and the existence of any prepayment penalty); contact information for the servicer (toll-free telephone number and, if applicable, e-mail address) and housing counselors (website address for either the CFPB or HUD list of approved counselors and the HUD toll-free telephone number which may be used to obtain a list of approved counselors); information on delinquencies if the consumer is more than 45 days past due (date delinquency occurred, notification of possible risks including foreclosure, an account history dating back to the time the account was last current or, if less, the prior 6 months, a notice indicating any loss mitigation program the consumer has agreed to, a notice of whether the servicer has made the first filing or notice required to begin foreclosure, the total amount to bring the loan current, and a reference to the homeownership counseling information disclosed earlier). These statements must meet the timing, form, and content requirements provided in the rule, and the rule contains sample forms.

Reverse mortgages and timeshare plans are exempt. In addition, the periodic statement requirement generally does not apply to fixed-rate loans if the servicer provides a coupon book, so long as the coupon book contains the following information: on each coupon, information about the payment coming due (including due date, amount, and the amount of any late charge and the date it will be imposed if payment is not received); in the coupon book, information about the account (including principal balance, current interest rate, next interest rate change date, and the existence of any prepayment penalty), contact information for the servicer (toll-free telephone number and, if applicable, e-mail address), and information about how the consumer can obtain the information that would otherwise be required to appear on a periodic statement. Most importantly, small servicers, as defined above, are exempt entirely from the billing statement/coupon book requirements.

Interest-rate adjustment notices for ARMs. The amendments to Reg. Z require servicers, including creditors and assignees, to provide a consumer whose mortgage has an adjustable rate with an early warning notice between 210 and 240 days before the first payment at the adjusted level comes due. If the first payment at the adjusted level is due within 210 days after consummation, then the notice must be given at consummation. This notice must be in a separate document and contain the date of the disclosure, an explanation that the current interest rate period is ending and that a change in the interest rate may result in a change in the mortgage payment, the effective date of the first interest rate adjustment and when additional rate adjustments are scheduled to occur, and any other changes to loan terms or features that may occur at the same time, such as the expiration of an interest-only or payment-option feature.

The notice must also include the current and new interest rate, current and new payment amounts, date the first new payment is due, and, for interest only or negatively amortizing payments, an explanation of how the current and new payment is allocated to principal, interest and escrows. If the new interest rate is not known at the time the notice is given, the new rate and new payment amount must be estimated based on the index used on the loan that is current within the last 15 days prior to the disclosure date and labeled as estimates.

The notice must also contain: an explanation of how the rate is determined (including the index used, a source of information for the index and an explanation of any margin added to the index); any limits on rate adjustments or payment increases at each adjustment period and over the life of the loan; an explanation of how the new payment amount is determined (including index, margin, loan balance on the date of the adjustment and length of remaining loan term); if the new rate and payment amounts are estimated, a statement that an additional notice will be provided between 2 and 4 months before a new payment at the adjusted amount comes due; for interest only payments, a warning that the new payment will not be allocated to principal and will not reduce the loan balance; for negatively amortizing payments, a warning that the new payment will not be allocated to principal, will pay only part of the interest due, thereby, adding to the loan balance, and the payment amount required to amortize the loan balance at the new interest rate over the remaining loan term; the circumstances under which any prepayment penalty may be imposed and a statement that the consumer may contact the servicer for more information; a telephone number for the consumer to call if they anticipate a problem making their new payment; a brief explanation of alternatives the consumer may pursue to avoid paying at the new rate including refinancing, selling the property, modifying the loan terms, and arranging a payment forbearance; website addresses for either the CFPB or HUD list of approved counselors, the HUD toll-free telephone number to obtain the HUD list and the CFPB website to access contact information for state housing finance authorities.

A similar notice must be provided between 60 and 120 days before a payment at a new level becomes due when a rate adjustment causes the payment to change. Generally, the disclosures

should be in the form of a table and in the same order and format as the model forms provided in the rule with certain disclosures to appear outside and above the table. The current annual notice that must be provided for ARMs for which the interest rate, but not the payment, has changed over the course of the year is no longer required.

Prompt payment crediting and payoff statements. The rules amend the existing Reg. Z requirements concerning prompt crediting of payments and responding to payoff requests. Servicers must promptly credit a periodic payment as of the day of receipt. A "periodic payment" is defined as one that is sufficient to pay principal, interest, and escrows (if applicable), whether or not it is also sufficient to cover any late charges, other fees or non-escrow payments a servicer has advanced. If a servicer receives a payment that is less than the amount due for a periodic payment, it may apply the partial payment or hold the partial payment in a suspense account until it receives enough to constitute a periodic payment. When the amount in the suspense account is enough to cover a periodic payment, the servicer must apply the funds to the consumer's account. Pyramiding of late fees is prohibited, meaning no late fee can be assessed based on the failure of the consumer to pay a late charge attributable to an earlier payment. In addition, creditors, assignees, and servicers must provide an accurate payoff balance to a consumer within a reasonable time and no later than seven business days after receipt of a written request from the borrower or any person acting on the borrower's behalf.

Force-placed insurance. Under the amendments to RESPA Reg. X, servicers are prohibited from charging a borrower for force-placed insurance coverage unless the servicer has a reasonable basis to believe the borrower has failed to maintain hazard insurance and has provided required notices. Force-placed insurance covered by the rule is servicer-placed hazard insurance other than required flood insurance and other than hazard insurance obtained by the borrower and renewed by the servicer. An initial notice must be sent to the borrower at least 45 days before charging the borrower for force-placed insurance coverage, and a second reminder notice must be sent no earlier than 30 days after the first notice and at least 15 days before charging the borrower for force-placed insurance coverage. Before force-placed coverage can be renewed, a notice must be sent at least 45 days before charging the borrower for the renewed coverage. The rule prescribes the content and format of the notices and contains model forms. Some information must be in bold text and the notices must be in a separate document; although, a separate mailing is not required. If mailed, the notices must be sent by first class mail or better.

If a borrower provides proof of hazard insurance coverage, the servicer must cancel any force-placed insurance policy and refund any premiums paid for overlapping periods in which the borrower's coverage was in place. The rule also provides that charges related to force-placed insurance, other than those subject to State regulation as the business of insurance (such as premiums approved by the state insurance commissioner) or authorized by Federal law for flood insurance, must be for a service that was actually performed and must bear a reasonable relationship to the servicer's cost of providing the service.

When an escrow account has been established for payment of taxes and insurance, RESPA requires a servicer to make timely disbursements and advance funds where necessary to pay escrow items as long as the borrower is not more than 30 days past due. The new rule changes that with respect to obtaining force-placed insurance. If the borrower has an escrow account for the payment of hazard insurance premiums, the servicer is prohibited from obtaining force-placed insurance even where the borrower is more than 30 days past due, unless the servicer is "unable to disburse funds from a borrower's escrow account to ensure that the borrower's hazard insurance premium charges are paid in a timely manner." A servicer is deemed unable to disburse funds to keep the borrower's insurance in force when there is a reasonable basis to conclude the policy was cancelled for reasons other than non-payment of the premium, such as where the insurance

company sends notice of cancellation or non-renewal before the premium is due. In essence, a servicer must continue the borrower's existing homeowner insurance whenever possible, even if the borrower is delinquent and the servicer must advance additional funds to the borrower's escrow account to do so.

Small servicers are exempt from the rule against obtaining force-placed insurance in cases in which hazard insurance is paid through an escrow account, so long as any force-placed insurance purchased by the small servicer is less expensive to the borrower than the amount of any disbursement the servicer would have made to maintain the borrower's hazard insurance coverage. Force-placed insurance is usually significantly more expensive than normal coverage, so this exemption may not mean very much as a practical matter. Small servicers are not exempt from the notice and other requirements for force-placed insurance.

Error Resolution and Information Requests. Servicers are required under Reg. X to meet certain procedural requirements for responding to written information requests or complaints of errors, including qualified written requests. The rule requires servicers to comply with the error resolution procedures for certain listed errors (including failure to properly accept, apply or timely credit a payment; failure to pay taxes, insurance premiums or other escrow items or to refund an escrow surplus in a timely manner; failure to provide an accurate and timely payoff statement; failure to provide accurate information concerning loss mitigation options and foreclosure; failure to provide accurate and timely information concerning a transfer of servicing; charging an unauthorized fee; initiating foreclosure, moving for a judgment or order of foreclosure, or conducting a foreclosure sale in violation of the rule), and any other error relating to the servicing of a mortgage loan. Servicers may designate by written notice a specific address for borrowers to use to assert an error.

Servicers generally are required to acknowledge the request or notice of error within five days (excluding Saturdays, Sundays and legal holidays). Servicers are also required, generally, to investigate and correct the error asserted by the borrower, and any additional errors discovered in the course of investigation, and to provide the borrower with written notification describing the action taken to correct the error, the effective date of the correction, and contact information including a phone number that can be used for further assistance. If the investigation finds that no error occurred, then the notice must include a statement of the reasons for that determination and the borrower's right to obtain copies of any documentation relied upon by the servicer, along with contact information including a phone number that may be used for that purpose. The servicer may request information from the borrower in connection with the investigation, but may not require it before initiating its investigation or use the failure to receive it as a reason for determining no error occurred without conducting an investigation.

There are time limits for responding to a notice of an error. For failure to provide a payoff statement – the time limit is 7 days after receipt of the notice, excluding Saturdays, Sundays and legal holidays. For errors relating to starting foreclosure, moving for a judgment or order of foreclosure, or conducting a foreclosure sale in violation of the rule, a response is due prior to foreclosure or within 30 days after receipt of notice; and for other errors, a response is due 30 days after receipt. For errors other than the first two listed, the 30 day period can be extended to 45 days by notifying the borrower in writing of the extension and the reasons for it. If the borrower requests copies of the documentation relied upon by the servicer in its investigation, the servicer must provide it within 15 days after receiving the borrower's request and at no charge. Privileged, confidential or proprietary information can be withheld on notice to the borrower within 15 days of receipt of the borrower's request.

The servicer can short-cut the investigation process entirely by correcting the error asserted by the borrower and notifying the borrower of the correction within 5 days after receiving the

borrower's notice. There are also exceptions to the notice and investigation requirements and deadlines for repetitive notices of the same error, vague or overbroad notices where the servicer cannot reasonably determine the specific error asserted, and notices of error received more than one year after the loan has been paid off or the servicing transferred to another servicer. If an exception applies, the servicer must respond to the borrower's notice within 5 days after receipt notifying the borrower of the reason no investigation will be made.

Servicers cannot charge a fee or require any payment owed to be made as a condition of responding to an error and may not, for 60 days after receipt of notice of an error, furnish adverse information to a consumer reporting agency regarding any payment that is the subject of the error notice. Except in connection with errors relating to initiating a foreclosure, moving for a judgment or order of foreclosure, or conducting a foreclosure sale, a servicer is free to pursue any remedy it might otherwise have against the borrower or the property, including foreclosure.

Information requests are treated in a similar fashion. Within a similar amount of time, servicers generally are required to acknowledge borrower written requests for information and either provide the information or explain why the information is not available. The distinction given a "qualified written request" under current rules pretty much goes away. The term still exists under the new rules, but a qualified written request is just a subset of error notices or requests for information and is subject to the same rules and deadlines.

General servicing policies, procedures, and requirements. Servicers are required to establish policies and procedures reasonably designed to achieve certain objectives specified in the rule. The reasonableness of a servicer's policies and procedures may take into account the size, scope, and nature of the servicer's operations. The objectives are divided into five categories and the rules provide more detail on the types of required policies and procedures for each category. The categories include: accessing and providing accurate and timely information to borrowers, investors, and courts (required policies and procedures should cover providing accurate and timely disclosures, responding to error notices and information requests, providing mortgage investors and assignees with information about the loan being serviced, proper handling of foreclosures and foreclosure documentation, and handling loans where the borrower has died); properly evaluating loss mitigation applications (including procedures dealing with making borrowers aware of available loss mitigation options, identifying all options for which the borrower may be eligible, identifying all information or documents the borrower is required to submit for consideration and then making sure all personnel assisting the borrower have access to it, and evaluating the borrower's application pursuant to the eligibility rules established by investors and required RESPA loss mitigation procedures); facilitating oversight of, and compliance by, third party service providers to the mortgage loan servicer (including procedures for appropriate servicer personnel to have access to documents and information concerning actions taken by the service provider, periodic reviews/compliance audits of the service provider, and facilitating sharing of information between servicer and service provider personnel regarding the status of any loss mitigation processes and foreclosure proceedings); facilitating transfer of information during servicing transfers (including procedures for transferors to assure transfer of complete and accurate information and procedures for transferees to identify any necessary information or documents it did not receive); and informing borrowers of the availability of written error resolution and information request procedures.

In addition, servicers are required to maintain certain documents and data for each mortgage loan in a manner that enables the servicer to compile it into a loan servicing file within five days. Required records include a schedule of all transactions on the account include any escrow or suspense accounts; a copy of the mortgage, deed of trust or other security instrument; any notes

created by servicing personnel reflecting communications with the borrower about the account; to the extent applicable, a report of the data fields relating to the account in the servicer's electronic systems; and copies of any documents or information provided by the borrower in connection with any error notices or loss mitigation procedures.

Small servicers, as defined above, are exempt from the requirements of this section along with "qualified lenders" subject to certain Farm Credit Administration rules.

Early Intervention with Delinquent Borrowers. For loans secured by the borrower's principal dwelling, servicers must establish or make good faith efforts to establish live contact with borrowers by the 36th day of their delinquency and promptly inform such borrowers, where appropriate, that loss mitigation options may be available. In addition, a servicer must provide a borrower a written notice with information about loss mitigation options by the 45th day of a borrower's delinquency. The written notice must include: a statement encouraging the borrower to contact the servicer; the telephone number to reach servicer personnel assigned to assist the borrower and the servicer's mailing address; if applicable, a brief description of available loss mitigation options; if applicable, loss mitigation application instructions or a statement on how to obtain more information; and the website to access either the CFPB or HUD list of approved counselors and the HUD toll-free telephone number to obtain the list. The rule contains model language servicers may use for the written notice.

Small servicers, as defined above, and "qualified lenders" under certain Farm Credit Administration rules are exempt from this section.

Continuity of contact with delinquent borrowers. For loans secured by the borrower's principal dwelling, servicers are required to maintain reasonable policies and procedures with respect to providing delinquent borrowers with access to personnel to assist them with loss mitigation options where applicable. The policies and procedures must be reasonably designed to ensure that a servicer assigns personnel to a delinquent borrower by the time the servicer provides the written notice required by the early intervention requirements, but no later than the 45th day of a borrower's delinquency. The personnel assigned should be accessible to the borrower by phone to assist the borrower in pursuing loss mitigation options, including advising the borrower on the status of any loss mitigation application and applicable timelines. The personnel should be able to access all information the borrower has provided to the servicer and furnish that information, when appropriate, to those responsible for evaluating the borrower for loss mitigation options.

This section includes an exemption for small servicers and qualified lenders as described above.

Loss Mitigation Procedures. A loss mitigation option is any alternative to foreclosure offered by the investor/owner of the mortgage loan that is made available through the servicer. The rules do not impose a duty on a servicer to make any specific loss mitigation option available to borrowers, but servicers offering any form of loss mitigation are required to follow specified loss mitigation procedures for those loss mitigation options available through the servicer for loans secured by the borrower's principal residence.

If a borrower submits an application for a loss mitigation option, the servicer is required to acknowledge the receipt of the application in writing within five days and inform the borrower whether the application is complete and, if not, what information is needed to complete the application and the deadline for providing it. The servicer is required to exercise reasonable diligence in obtaining documents and information to complete the application.

For a complete loss mitigation application received more than 37 days before a foreclosure sale, the servicer is required to evaluate the borrower, within 30 days, for all loss mitigation options for which the borrower may be eligible in accordance with the investor's eligibility rules,

including both options that enable the borrower to retain the home (such as a loan modification) and non-retention options (such as a short sale). Servicers are free to follow the requirements and guidelines established by the investor to determine eligibility for particular loss mitigation options. The servicer must provide the borrower with a written decision, including an explanation of the specific reasons for denying the borrower for any loan modification option offered by the investor and a statement of the borrower's right to appeal the denial. A borrower may appeal a denial of a loan modification program so long as the borrower's complete loss mitigation application is received 90 days or more before a scheduled foreclosure sale. The appeal must be reviewed by personnel independent of those responsible for evaluating the borrower's original loss mitigation application.

The rule restricts "dual tracking," where a servicer is simultaneously evaluating a consumer for loan modifications or other alternatives at the same time that it prepares to foreclose on the property. Specifically, the rule prohibits a servicer from making the first notice or filing required for a foreclosure until a mortgage loan account is more than 120 days delinquent. Even where a borrower is more than 120 days delinquent, if a borrower submits a complete application for a loss mitigation option before a servicer has made the first notice or filing required for a foreclosure, a servicer may not start foreclosure unless (1) the servicer informs the borrower that the borrower is not eligible for any loss mitigation option (and any appeal has been exhausted), (2) a borrower rejects all loss mitigation offers, or (3) a borrower fails to comply with the terms of a loss mitigation option, such as a trial modification.

If a borrower submits a complete application for a loss mitigation option after the foreclosure process has commenced but more than 37 days before a foreclosure sale, a servicer may not move for a foreclosure judgment or order of sale, or actually conduct a foreclosure sale, until one of the same three conditions above has been satisfied. In all of these situations, the servicer is responsible for promptly instructing any legal counsel retained by the servicer not to proceed with filing for a foreclosure judgment or order of sale, or to conduct a foreclosure sale, as applicable.

This section includes an exemption for small servicers, as defined above, and "qualified lenders" that are required to comply with Farm Credit Administration regulations relating to distressed borrowers. However, a small servicer is still required to comply with two requirements: (1) a small servicer may not make the first notice or filing required for a foreclosure process unless a borrower is more than 120 days delinquent, and (2) a small servicer may not proceed to foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing pursuant to the terms of a loss mitigation agreement.

Civil Liability. With two exceptions, the CFPB is relying, at least in part, on its authority under Section 6 of RESPA, as amended by Dodd-Frank, in issuing the Reg. X servicing rules. For the two sections requiring reasonable policies and procedures to meet the overall servicing objectives and reasonable policies and procedures to maintain continuity of contact with delinquent borrowers, the CFPB is relying only on its authority under Section 19(a) of RESPA. This distinction is important. Violations of Section 6 of RESPA may be enforced by individual borrowers through litigation. Section 6(f) of RESPA provides that servicers may be liable in a civil action for actual damages, statutory damages of up to $2,000 for a pattern or practice of non-compliance (up to $2,000 per classmember in a class action, not to exceed the lesser of $1,000,000 or 1% of the servicer's net worth), plus attorneys' fees. So, there is the potential for civil liability for violations of the new servicing requirements under either Reg. Z (Truth in Lending) or Reg. X (RESPA), except with respect to the requirements to establish reasonable policies and procedures in those two areas. The CFPB apparently listened to industry and decided that it would be inappropriate to provide for civil liability for violations of those two sections which set forth broad and flexible policy and procedure requirements. Nevertheless, there is a significant

risk for civil liability for other violations. In particular, the requirements for early intervention and loss mitigation procedures may give borrowers a significant potential claim or defense to use in foreclosure proceedings. And, of course, the CFPB and the prudential regulators have authority over servicers within their jurisdiction to bring enforcement actions to assure compliance with all of the new requirements.

Effective Date; Implementation. The effective date for both of these rules is January 10, 2014. While that sounds like a long way off, the final rules will, in many cases, require development of extensive written servicing procedures, revisions to software, staff training, and other changes. Thankfully, there is a break for small servicers with respect to at least some of the requirements. Even small servicers, however, may be wise to review their existing policies and procedures, keeping the new rules for larger servicers in mind as a guide. The CFPB has said it will be working to provide additional information and guidance to help the mortgage servicing industry to implement the new rules by the effective date.

<Cliff Harrison>

FINAL RULES ON MORTGAGE LOAN ORIGINATOR COMPENSATION AND QUALIFICATIONS

On January 20, 2013, the Consumer Financial Protection Bureau (CFPB) issued final regulations implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) provisions concerning loan originator qualification requirements and compensation practices. According to the CFPB, prior to the mortgage crisis, training and qualification standards for loan originators varied widely, and compensation was often designed in a way to give loan originators incentives to steer consumers into more expensive loans. Consumers also frequently paid loan originators (brokers) an upfront fee thinking the broker was there to obtain the best possible loan for the consumer without realizing that the lender was also paying commissions or a yield spread to the originator that increased with the interest rate or other terms.

Congress passed the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) in 2008 requiring loan originators to be licensed or registered and to pass background checks and meet other requirements. In 2011, the Fed amended Regulation Z to prohibit payment of compensation to loan originators based on any of the terms or conditions of a loan. Dodd-Frank expanded on those prior efforts to strengthen loan originator qualifications and regulate compensation practices, and the CFPB issued its new rules to implement the Dodd-Frank provisions and to revise and clarify the existing regulations and commentary on compensation. The rules also implement Dodd-Frank provisions prohibiting use of mandatory arbitration agreements and financing single premium credit insurance in connection with mortgage loans. The final rule revises Regulation Z and the changes are summarized below.

Prohibition against compensation based on a loan term or a proxy for a loan term. Reg. Z already prohibits compensation based on "any of the transaction's terms or conditions." Dodd-Frank codified this existing prohibition. The final rule implements the Dodd-Frank provisions and clarifies the scope of the rule in several ways.

The final rule defines "a term of a transaction" as "any right or obligation of the parties to a credit transaction." This means, for example, that a loan originator employee cannot receive compensation based on the interest rate of a loan or on the fact that the loan originator steered a consumer to purchase required title insurance from an affiliate of the lender, since the consumer is obligated to pay interest and the required title insurance is in connection with the loan. The rule generally prohibits compensation to mortgage loan originators based on a term of an individual transaction, the terms of multiple transactions by an individual loan originator, or the terms of multiple transactions by multiple loan originators. Compensation may still be based on loan volume and, with certain limitations, on loan amount.

The final rule also prohibits compensation based on any "proxy" for a term of a transaction and clarifies the definition of a proxy to focus on whether: (1) the factor consistently varies with a transaction term over a significant number of transactions; and (2) the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating the transaction. The basic question is whether or not the compensation of the loan originator would be different if any term of the transaction were different.

The final rule generally prohibits loan originator compensation from being reduced to offset the cost of a change in transaction terms (often called a "pricing concession"). For example, an originator could not agree to give up part of his or her compensation in order to provide a credit to the consumer to pay a portion of the consumer's closing costs. However, the final rule does allow a loan originator to reduce his compensation to defray certain unexpected increases in estimated settlement costs. For example, a bank's compensation plan for its mortgage loan originators could include a deduction from the originator's compensation to pay all or part of the amount needed to cure a RESPA disclosure tolerance violation.

To prevent providing incentives to steer or "up-charge" consumers on their loans, the final rule generally prohibits compensation based on the profitability of a transaction or a pool of transactions or overall profitability of a department or organization that includes profits from covered mortgage loans. However, the final rule makes exceptions to this prohibition for contributions to certain kinds of retirement, profit-sharing and bonus plans.

Contributions to a "designated tax-advantaged plan" may be made based on profitability of mortgage-related business activity. A "designated tax-advantaged plan" is basically any IRS qualified defined benefit or defined contribution plan and includes a 401(k), employee annuity plan, simple retirement account, simplified employee pension, or eligible deferred compensation plan, all as defined in specified sections of the Internal Revenue Code. Bonuses and contributions to other non-deferred incentive plans may be made based on mortgage business profits provided that the amount of the bonus or contribution paid to an individual loan originator is not based, directly or indirectly, on the terms of that individual originator's loan transactions and, either, the bonus or contribution does not exceed 10% of the individual's total compensation for the same period (including the bonus payment), or the individual was a loan originator for 10 or fewer transactions during the preceding 12 months. The 10% cap on bonus payments only applies to payments based on profits from mortgage-related business. So, to the extent a bank can allocate revenues and expenses between its covered mortgage-related business activity (keeping in mind that the rule applies to all consumer closed-end dwelling secured loans) and its other lines of business, then, bonus payments may be based on profitability of other types of business without regard to the 10% cap. Managers who engage in limited loan origination may fall within the exception for 10 or fewer transactions allowing them to receive bonus payments based on overall bank or branch profitability, including mortgage-related profits. These changes provide much needed clarifications with respect to retirement plan contributions and incentive/bonus plan payments.

Definition of "loan originator. The rule clarifies the definition of "loan originator" for purposes of the compensation and qualification rules, including exclusions for certain employees of manufactured home retailers, servicers, seller financers, and real estate brokers; management, clerical, and administrative staff; and loan processors, underwriters, and closers. Existing Reg. Z defines the term "loan originator" as any person who for compensation or gain, or expectation of compensation or gain, "arranges, negotiates or otherwise obtains an extension of consumer credit for another person." The new rule expands on that definition and defines the term as any person who for direct or indirect compensation or other monetary gain, or in

expectation thereof, "takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or through advertising or other means of communication represents to the public that such person can or will perform any of these activities."

The new rule also makes a distinction between an "individual loan originator," which is a natural person, and a "loan originator organization," which is any loan originator that is other than a natural person. So, a bank will be a loan originator organization and its loan originator employees will be individual loan originators. This distinction comes into play in connection with several requirements of the new rule.

With respect to managers, administrative, and clerical staff, the revised commentary provides examples of the types of activities those persons may engage in without becoming a loan originator. For example, simply handing out an application form, accepting a completed form, providing general information in response to customer questions, providing loan originator contact information, discussing other credit products and services, or providing general guidance on qualifications or criteria without discussing or assessing the consumer's specific circumstances or discussing particular credit terms available from the creditor does not make an employee a loan originator. Backroom loan processors and personnel involved in underwriting, credit approval and loan pricing are not loan originators provided that communications with the consumer about things such as underwriting decisions, specific credit terms, a specific offer of credit, a counter-offer, approval conditions and any negotiations about terms takes place through a loan originator.

Because the definition of loan originator includes any person who takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person, a person who engages in any of those activities is covered even if most of their duties are unrelated to loan origination. As a result, managers who only occasionally engage in loan origination activity (so called "producing managers") are covered. Servicers and servicer employees, including those who deal with consumers on loan modifications, are excluded, as are realtors and certain others. The rule includes a somewhat complicated exemption for certain types of seller financing following the language of Dodd-Frank.

While the revised definition of "loan originator" is similar in many respects to the definition of "mortgage loan originator" contained in the SAFE Act and regulations, lenders should take note that the Reg. Z definition is actually broader. Under Reg. Z, a person is a loan originator if he or she "takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, <u>or</u> otherwise obtains or makes an extension of consumer credit for another person." Doing any one of those things makes a person a loan originator. Under the SAFE Act and regulations, a person is generally considered to be a mortgage loan originator if he or she takes a residential mortgage loan application <u>and</u> offers or negotiates terms of a residential mortgage loan. As a result, coverage of the compensation and qualification rules could extend beyond those originators in the bank who are required to be registered as a mortgage loan originator in the national registry. That may present a compliance challenge and could require some analysis of job descriptions and responsibilities.

<u>Prohibition against dual compensation</u>. Reg. Z already prohibits a loan originator who receives compensation directly from a consumer from receiving compensation from any other person in connection with the same mortgage loan. Dodd-Frank codifies this prohibition, and the final rule implements this restriction but provides an exception clarifying that mortgage brokers receiving compensation from the consumer directly may pay commissions to their employees or contractors, although the commissions cannot be based on the terms of the loans that they originate.

No prohibition on upfront points and fees. Section 1403 of Dodd-Frank generally prohibits payment by consumers of upfront points or fees on transactions in which the loan originator compensation is paid by a person other than the consumer (which would apply to transactions where the lender pays its own employee originators as well as to payments by a creditor to a mortgage broker). However, Dodd-Frank also authorized the CFPB to waive or create exemptions from the prohibition on upfront points and fees if it determines that would be in the interest of consumers and in the public interest. In its original proposal, the CFPB proposed to waive the ban and allow creditors to charge upfront points and fees on a mortgage loan, so long as they also offered to the consumer a “no points and fees” alternative. The CFPB decided not to adopt the proposed rule and, instead, issued a complete exemption to the prohibition on upfront points and fees. The CFPB’s stated reasons were the risk of consumer confusion and possible impact on the availability of credit in light of the major regulatory overhaul of the mortgage market that is underway. The CFPB intends to study the issue further, conduct consumer testing and other research, and, then, decide whether further regulation is appropriate.

Loan originator qualifications. Dodd-Frank imposes a duty on individual loan officers, mortgage brokers, and creditors to be "qualified" and, when applicable, registered or licensed to the extent required under State and Federal law. The final rule imposes duties on loan originator organizations to make sure that their individual loan originators are licensed or registered as applicable under the SAFE Act and other applicable law. For banks and other employers whose employees are not required to be licensed (including all depository institutions, their subsidiaries, and bona fide non-profits), the rule also requires them to: (1) ensure that their loan originator employees meet character, fitness, and criminal background standards similar to existing SAFE Act licensing standards; and (2) provide training to their loan originator employees that is appropriate and consistent with those employees' origination activities.

With respect to character, fitness and background standards, the revised rule requires a loan originator organization to obtain three basic things about each of its individual loan originators: a criminal background check, information about any administrative, civil or criminal findings, and a credit report. For mortgage loan originators who are registered or licensed in the national registry, the requirement for a criminal background check and collection of information about administrative, civil or criminal findings will have been satisfied through the licensing or registration process. Banks and others employing loan originators will need to obtain credit reports on individual loan originators hired after January 10, 2014, but it is not clear whether it will be necessary to obtain a credit report on licensed or registered originators hired before that date.

For any person who is a “loan originator” under Reg. Z, but is not registered or licensed as a “mortgage loan originator” in the national registry, it will be necessary for the employer to conduct its own assessment of whether the person meets equivalent standards. That means the employer must obtain a criminal background check through a law enforcement agency or commercial service and obtain information about administrative, civil or criminal findings directly from the individual, as well as obtain a credit report, before the person can act as a loan originator.

The final rule contains special provisions with respect to criminal background checks and the circumstances in which a criminal conviction is disqualifying. Generally, any person who has been convicted or pleaded guilty or *nolo contendere* to a felony during the previous 7 years, or in the case of a felony involving an act of fraud, dishonesty, a breach of trust, or money laundering, at any time, is ineligible to serve as a loan originator.

In its original proposal, the CFPB had considered imposing on non-licensed loan originators (including registered loan originator employees of banks) the same types of pre-licensing and continuing education requirements that apply to State licensed mortgage loan originators. In the final rule, the CFPB only included a general requirement that loan originators receive periodic training covering State and Federal law requirements that apply to the person's loan origination activities.

NMLSR identifier requirements. The final rule also implements a Dodd-Frank requirement that loan originators provide their unique identifiers under the Nationwide Mortgage Licensing System and Registry (NMLSR) on loan documents. Accordingly, the name and NMLSR ID, if one, of the loan originator organization and the name and NMLSR ID of the individual loan originator employee that is primarily responsible for a particular origination must be listed on the credit application, note, and the mortgage or deed of trust.

Prohibition on mandatory arbitration. The final rule contains language implementing a Dodd-Frank provision which prohibits use of mandatory arbitration clauses and agreements in connection with any consumer credit transaction secured by a dwelling (including any home equity line of credit secured by the consumer's principal dwelling). It does not prohibit a voluntary agreement to arbitrate a dispute once the dispute has arisen. The rule also prohibits the application or interpretation of any of provision in any such loan or credit contract in a manner that would waive, or bar a consumer from bringing, a claim in court for damages or other relief in connection with any alleged violation of Federal law.

Single premium credit insurance. The rule implements a Dodd-Frank provision which prohibits the financing of any premiums or fees for credit insurance (including credit life, disability, unemployment or credit property insurance, and debt cancellation/debt suspension contracts) in connection with a consumer credit transaction secured by a dwelling (including any home equity line of credit secured by the consumer's principal dwelling), but allows credit insurance to be paid for on a monthly basis.

Policies and procedures. The rule includes a requirement that all depository institutions must establish and maintain written policies and procedures reasonably designed to ensure and monitor compliance of the depository institution, its employees, its subsidiaries and the employees of its subsidiaries with the rules on loan originator compensation, prohibited steering, loan originator qualifications, and use of the NMLSR identifiers. The policies and procedures must be appropriate to the size, nature, complexity and scope of the mortgage lending activities of the institution and its subsidiaries.

Recordkeeping. The final rule also extends existing recordkeeping requirements concerning loan originator compensation so that they apply to both creditors and mortgage brokers for three years. A creditor must maintain records of all compensation it pays to a loan originator and any compensation agreement that governs those payments for at least 3 years after the payment. A loan originator organization must maintain records of all compensation it received from a creditor, a consumer or another person, and all compensation it pays to any individual loan originator and any related compensation agreement, for at least 3 years.

Effective dates; Implementation. The prohibitions against use of mandatory arbitration and financing credit insurance premiums become effective June 1, 2013. The remaining parts of the rule are effective on January 10, 2014. To a large extent, this rulemaking is an expansion and clarification of the existing rules on loan originator compensation. It may be necessary for a bank to give some additional consideration to identifying all persons who may be a loan originator under Reg. Z. It will be necessary to revise existing policies and procedures to take the rule changes into account, revise loan forms and procedures to add NMLSR identifiers and remove any

mandatory arbitration clauses or provision for financing credit insurance, and, possibly, to revisit compensation and bonus plans for loan originators and their managers.

<Cliff Harrison>

CFPB ANNOUNCES NEW HOEPA RULES

As you will recall, the Home Ownership Equity Protection Act (HOEPA) was enacted in 1994 as an amendment to the Truth-in-Lending Act and addressed abusive acts and practices in refinancing and home-equity mortgage loans with high interest rates or high fees.

The Dodd-Frank Act greatly expanded the coverage of HOEPA and added a number of protections for these so-called "High-Cost" mortgage loans.

On January 10, 2013, the CFPB issued its Final Rule, designed to strengthen the protections for consumers that find themselves in a High-Cost Mortgage. This rule is one of several announced by the CFPB in advance of its legislative deadline of January 21, 2013.

Banks have a threshold question to ask: How likely is it that our bank will make "High-Cost" (HOEPA) loans?

The Dodd-Frank Act did two things that would make it more likely that your bank would originate some of these loans. First, it expanded significantly the universe of loans covered by HOEPA. Now, most mortgage loans secured by a consumer's principal dwelling are covered. These loan types include purchase-money mortgages (new), refinance loans, closed-end home-equity loans, and home-equity lines of credit (new). (construction loans and loans originated and financed by Housing Finance Agencies are exempt.)

The second method that the Dodd-Frank Act used to expand HOEPA coverage was an expansion of the APR and Points and Fees triggers. Now a loan will be a High-Cost (HOEPA) loan if any of the following tests are met:

- The loan's annual percentage rate (APR) exceeds the applicable average prime offer rate (APOR) by more than 6.5 percentage points for most first-lien mortgages or by more than 8.5 percentage points for a first mortgage if the dwelling is personal property and the transaction is for less than $50,000.00;
- The loan's APR exceeds the applicable average prime offer rate (APOR) by more than 8.5 percentage points for subordinate or junior mortgages;
- The loan's points and fees exceed 5% of the total transaction amount or, for loans below $20,000.00, the lesser of 8% of the total transaction amount or $1,000.00; or
- The loan documents permit the creditor to charge or collect a pre-payment penalty more than 36 months after the loan closing or permit such fees or penalties to exceed, in the aggregate, more than 2% of the amount pre-paid.

The Final Rule also provides guidance on how to apply the various coverage tests such as how to determine the applicable APOR and how to calculate points and fees.

In effect, these changes do the following:

- Change the APR benchmark from the yield on comparable Treasury Securities to the "average prime offer rate;"
- Revise the percentage-point thresholds for first-lien and subordinate-lien loans; and
- Create a separate, high percentage-point threshold for small dollar amount, first-lien loans secured by personal property (e.g. mobile homes, etc.)

For the time being, one potential point of confusion has been put to rest. The CFPB had originally proposed two alternative approaches to calculating the APR trigger. Alternative 1 used the APR compared to the APOR. Alternative 2 would have used much the same approach, but would have substituted a "transaction coverage rate" for the APOR to be compared to the APR. The second alternative would have been applicable if the CFPB elected to expand significantly the definition of "finance charge" under the Truth-in-Lending Act to include virtually all costs of loan origination. The CFPB has elected to postpone a decision on expanding the finance charge definition until it finalizes its TILA-RESPA Integration Proposal sometime later this year. For now, Alternative 1 (APR compared to APOR) is the metric.

The CFPB's Final Rule also implements new restrictions and requirements contained in the Dodd-Frank Act concerning loan terms and origination practices for HOEPA loans. For example:

- Balloon payments are generally banned, unless they meet certain limited criteria, including those lenders operating predominately in rural or underserved areas. The exception for balloon loans made by small creditors operating predominantly in rural or underserved areas has several parts or conditions. A "small" creditor is defined as: (1) one with less than $2 billion in assets; (2) that extends 500 or fewer first-lien loans in the preceding year; and (3) made more than 50% of its covered loans in a rural or underserved area. This exception is identical to the exception for small creditors making balloon loans under the Ability-To-Pay/Qualified Mortgage Rule (discussed in a related article). The key points will be the 500 loan limit and whether those loans are made predominantly in "rural or underserved" areas. The CFPB will publish a list of rural and underserved markets. If a bank fails to qualify, it will not be able to make balloon loans if they would also be HOEPA loans.

- Creditors are prohibited from charging pre-payment penalties and financing points and fees.

- Late fees are restricted to 4% of the payment that is past due, fees for providing pay-off statements are restricted, and fees for loan modification or payment deferral are banned.

- Creditors originating HELOC's are required to assess a consumer's ability to re-pay (of course closed-end credit transactions are already subject to the ability to re-pay requirement.)

- Creditors and Mortgage Brokers are prohibited from recommending or encouraging a consumer to default on a loan or debt to be refinanced by a High-Cost Mortgage.

- Before making a High-Cost Mortgage, creditors are required to obtain confirmation from a Qualified Homeownership Counselor that the consumer has received counseling on the advisability of the mortgage.

Based on its research and the comments it received, the CFPB doesn't appear to believe that this revised High-Cost Mortgage Rule will have a wide-spread impact. It reported that from 2004 through 2009 between 1000 to 2000 creditors reported making HOEPA loans. Between 80% and 90% of those making High-Cost loans made fewer than ten of these loans annually. Even with the expanded coverage and lower thresholds under the new Final Rule, the CFPB believes that High-Cost Mortgages will constitute only a small percentage of the mortgage loan origination business.

For starters, you should determine if your bank's pricing or fee structure is likely to generate HOEPA loans. You should also review all prepayment penalty provisions in your loan documents, including any that may be hard coded into your loan documentation platform. Assuming you can establish parameters that avoid this class of loans generally, you may wish to

establish a review process to check each primary dwelling-secured loan to make sure no HOEPA loans slip through the cracks. Remember that an inadvertent HOEPA loan can be corrected, but that correction must occur within thirty (30) days of origination.

Finally, be alert to future action by the CFPB on the subject of "Finance Charge." If that definition is changed dramatically, it could have a significant impact on the APR trigger under HOEPA, turning many more of your loans into High-Cost (HOEPA) loans.

<Ed Wilmesherr>

CFPB ISSUES FINAL RULE FOR ESCROW ACCOUNTS

The CFPB issued its final rule for escrow accounts on January 10, 2013. The rule applies to higher-priced mortgage loans. The final rule extends the length of time for which escrow accounts for higher-priced mortgage loans must be maintained, and provides exceptions for qualifying institutions, communities such as condominiums, initial construction loans and bridge loans.

Beginning on June 1, 2013, escrow accounts for higher priced mortgage loans must be maintained for five years. This is a change from the current one year requirement. Additionally, the rule established limitations on the cancellation of an escrow account. An escrow account may only be cancelled under certain circumstances. In addition to cancellation upon termination of the underlying debt, the account may be cancelled after five years from origination only upon the customer's request. The customer's request may be approved if the principal balance is less than 80% of the original value of the property securing the loan and the customer is not currently delinquent on the loan. If those two conditions are not met, then the cancellation must be delayed.

The final rule provides for several exceptions. The first is an exception for creditors that "operate predominately" in rural or underserved markets. In order to take advantage of this exception, a creditor must: (1) originate more than half of its first-lien mortgages in rural or underserved areas; (2) have less than $2 billion in assets; (3) have originated no more than 500 first-lien mortgages in the preceding calendar year; and (4) not escrow for any mortgage it currently services, except in limited instances. It is important to note that even if a creditor meets the requirements for this exception, an escrow account must be established if, at origination, the loan is subject to a commitment to be sold to a creditor that does not meet the requirements for this exception.

There is also an exception in place for "common interest communities" such as condominiums in which participation in a governing association is a requirement to home ownership, as well as for financing the construction of a dwelling, and bridge loans with terms of twelve months or less.

The final rule will apply to applications received on or after June 1, 2013.

<Memrie Fortenberry>

REMITTANCE TRANSFER UPDATE

In November 2012, we sent you a special bulletin updating you on anticipated changes to the remittance transfer rule for international transfers expected to be proposed by the CFPB. On December 31, 2012, the CFPB issued the proposed rule. As expected, the proposed amendments relate to changes in the error resolution procedures for instances in which funds are credited to a wrong account as a result of sender error. The proposal also addresses disclosure requirements for third party fees and foreign taxes, and provides some relief by allowing remittance transfer providers to disclose the highest possible tax or fee that may be imposed. Additionally, for foreign tax disclosures, the use of foreign taxes imposed at a national level, as opposed to those taxes levied at a local,

state, or sub-national level, is proposed. The comment period closed on January 31, 2013.

More recently, on January 22, 2013, the CFPB issued a final rule announcing the delay of the February 7, 2013 effective date for the rule. It is expected that the effective date will be 90 days after the December 2012 proposed changes are finalized. At present, a new effective date has not been established.

<Memrie Fortenberry>

WHY BANKS NEED THE CFPB (And a Confirmed Director)

Many of you have seen or heard reports of the action taken last week by the U.S. Court of Appeals for the D.C. Circuit which held that appointments to the National Labor Relations Board, made by President Obama in January of 2012, were unconstitutional. Of course, President Obama made a similar recess appointment of Richard Cordray to be the new Director of the CFPB, on the same date and invoking the same authority, which raises the question of whether or not actions taken by the CFPB and issued under Director Cordray's authority are valid.

Undoubtedly this decision will be appealed, and there is authority to uphold regulations issued in good faith and reliance upon the authority of a regulatory agency; however, there is an even more cogent argument for wanting the CFPB's new regulations to be upheld.

The Dodd-Frank Act amended a number of laws in very significant ways. It codified a duty of care for mortgage loan originators. It expanded the concept and application of the Ability-to-Pay Rule. It called for regulatory action to define a Qualified Mortgage, which would give lenders some level of protection in the form of either a safe harbor or a presumption of compliance. It placed limits on mortgage loan originator compensation, but left to the CFPB the task of filling in the details. But at the end of the day, the Dodd-Frank Act provided that these changes in law would become effective 18 months after passage, whether regulations are in place or not.

Of course, this explains the CFPB's rush to issue the several Final Rules that are discussed elsewhere in this edition of the Quarterly Report.

Everyone should be aware that banks need the certainty and the guidance that these regulations give. Without those regulations, banks will know that there are requirements, but will lack the necessary guidance and flexibility when it comes to meeting those requirements.

Don't be confused by political rhetoric about using this ruling to repeal the Dodd-Frank Act or to significantly change the structure and function of the CFPB. Repeal of Dodd-Frank will not happen. Too much water is under the bridge. Some reform might occur, but implementation of items such as the Qualified Mortgage Rule must begin now. Waiting to see the final outcome of appeals and political wrangling will only leave your bank without enough time to make the important changes that will be necessary.

Everyone should hope that this is one football that the Republicans and Democrats in Congress do not decide to run with. Too much uncertainty would result.

<Ed Wilmesherr>

CFPB ISSUES RULES ON APPRAISALS FOR HIGHER PRICED MORTGAGE LOANS

The Consumer Financial Protection Bureau has issued its regulations, amending Regulation Z, concerning requirements for appraisals for higher-priced mortgage loans. The regulations were issued on January 18, 2013 and will become effective on January 18, 2014.
The rules were issued jointly with the Federal Reserve Board, the OCC, the FDIC, the NCUA, and the Federal Housing Finance Agency.

These rules were adopted in response to requirements of the Dodd Frank Act to establish appraisal requirements for "higher-risk" mortgage loans. In developing the actual rules, the CFPB and the agencies opted to apply the rules to "higher-priced" mortgage loans ("HPML") because the two definitions are substantially similar, and lenders already have familiarity with the "higher-priced" mortgage definition. The rules establish a general requirement that a written appraisal be obtained in connection with making an HPML. The written appraisal must be performed by a certified or licensed appraiser, and it must involve a physical property visit of the interior of the property by the appraiser.

As defined in the rules, an HPML is a closed-end consumer credit transaction secured by the consumer's principal dwelling with an interest rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by (i) 1.5 or more percentage points for conventional loans, (ii) 2.5 or more percentage points for jumbo loans, and (iii) 3.5 or more percentage points for loans secured by a subordinate lien. The appraisal requirements do not apply to (a) a qualified mortgage, (b) a loan secured by a new manufactured home, (c) a loan secured by a mobile home, boat, or trailer, (c) a loan to finance initial construction of a dwelling, (d) a bridge loan with maturity of 12 months or less for the purpose of acquiring a consumer's principal dwelling, or (e) a reverse-mortgage.

At the time of the consumer's application for the loan, the applicant must be provided with a notice advising of the purpose of the appraisal and that the lender will provide the applicant with a copy of the written appraisal. This notice must be provided to the consumer no later than the third business day after receipt of the consumer's application for an HPML. The lender may charge a fee for conducting the appraisal, but may not charge an additional fee for providing the required copy of the appraisal to the applicant. The copy of the written appraisal must be provided to the applicant at least three (3) business days before consummation of the loan, or if the loan is not consummated, within 30 days of the date that the lender determines that the loan will not be consummated. The applicant must be notified that the applicant may obtain an appraisal from another appraiser, at the applicant's expense. The rules provide sample forms of the required notice.

There is an additional requirement that two (2) written appraisals be obtained under certain circumstances. The two (2) appraisal requirement applies when (a) the seller acquired the property 90 or fewer days prior to the date of the consumer's contract to acquire the property and the consumer's contract price exceeds the seller's acquisition price by more than ten (10) percent, or (b) the seller acquired the property 91 to 180 days prior to the date of the consumer's contract to acquire the property and the price in the consumer's contract price exceeds the seller's acquisition price by more than 20 percent. Each of the 2 appraisals must be performed by a different appraiser, and at least 1 of the appraisals must include analysis of (i) the difference between the price at which the seller acquired the property and the consumer's contract price, (ii) changes in market conditions between the date the seller acquired the property and the date of the consumer's contract, and (iii) any improvements made to the property between the date the seller acquired the property and the date of the consumer's contract. The cost of only one (1) of the appraisals may be charged to the consumer/applicant. The other appraisal will be an expense of the lender.

The lender must exercise reasonable diligence in making a determination as to whether the requirement for obtaining 2 appraisals applies to a given loan. The rule requires that the determination be made based upon "written source documents" and a list of examples of the types of written documents is included in an appendix to the rule. Among the types of documents listed in the appendix are a copy of the recorded deed under which seller took title, property tax bills, owner's title insurance policies, settlement statements from the seller's acquisition of the property, and sales price data recorded in a multiple listing service.

Certain types of transactions are exempt from the two (2) appraisal requirement, including (1) property acquired by the consumer from a local, State or Federal government agency, (2) property acquired from a person who acquired title through foreclosure, deed-in-lieu of foreclosure or other judicial or non-judicial proceeding relating to a mortgage loan default, (3) property acquired from a non-profit entity as part of a local, State, or Federal government program through which the non-profit entity may acquire title to foreclosed properties for resale, (4) property acquired by inheritance or a divorce decree, (5) property acquired from an employer or relocation agency in connection with an employee relocation, (6) property acquired from a servicemember pursuant to a deployment or change of station order, (7) property located in a designated federal disaster area as recognized by the Federal financial institution regulatory agencies, and (8) property located in a rural county.

The requirements of this rule are quite complex, and should be examined and carefully analyzed in light of the impact on an institution's lending practices and procedures, particularly as they relate to HPML's.

<Virginia Wilson>

CFPB PUBLISHES NEW RULES ON DISCLOSURE AND DELIVERY FOR COPIES OF APPRAISALS

Pursuant to requirements of the Dodd-Frank Act, the Consumer Financial Protection Bureau has issued rules amending Regulation B that concern customer notification of, and a requirement to furnish free copies of written appraisals and other written valuations used in connection with an application for any loan secured by a first lien on a dwelling. This rule is separate, and distinguishable, from the rule requiring written appraisals on higher-priced mortgage loans. These rules became final on January 18, 2013 and will become effective on January 18, 2014.

The rules amend the appraisal provisions found in Regulation B (implementing the Equal Credit Opportunity Act). Previously, Regulation B required that a lender provide an applicant with a copy of any appraisal report used in connection with an application for a mortgage loan secured by residential real property, upon the applicant's request. Under the Dodd-Frank Act, lenders will be required to automatically provide applicants with a copy of a written appraisal report or other valuation report prepared in connection with an application for a first lien loan to be secured by a dwelling. The applicant must also receive a notification/disclosure concerning the appraisal at the beginning of the application process. The requirements of the rules may be satisfied through electronic delivery of the copies and/or notifications.

The notification requirement establishes that within three (3) business days of receiving an application, the lender must provide the applicant with a notice of the applicant's right to receive a free copy of any appraisal or written valuation developed in connection with the application. If the application is not originally intended to be secured by a first lien on a dwelling, and later is amended to be so secured, the notice must be delivered within 3 business days of the lender's determination that the loan is to be secured by a first lien on a dwelling. Sample language for the notification is included in the rules.

The copy of the appraisal or valuation must be provided free of charge to the applicant, but the applicant may be charged with the reasonable cost of the appraisal. The copy of the appraisal must be provided to the applicant promptly upon completion of the appraisal, or within 3 business days prior to consummation of the loan, or, in the case of open-end credit, prior to account opening. If the loan is not consummated or the account is not opened, the lender must provide the copy within 30 days of determination that the closing will not occur. There is a provision for the applicant to waive the timing requirement for receipt of the copy at least 3 business days prior to the closing, but the waiver itself must be delivered at least 3 business days prior to the closing. The requirement to furnish a copy of any appraisal or valuation apply whether the credit is extended or denied or if the application is incomplete or withdrawn.

Note that the requirements of these rules apply more broadly than those concerning the HPML appraisal requirements. These requirements apply to both closed-end and open-end loans secured by a first lien on a dwelling. Also, pursuant to the definition of a "dwelling" in the rules, the requirements apply to any one-to-four family residential structure, and includes condominiums, cooperatives, mobile, or other manufactured homes.

<Virginia Wilson>

MRCG MEETING TO BE HELD ON FEBRUARY 21, 2013

The MRCG will hold its February Quarterly Meeting on February 21, 2013, at the Mississippi Sports Hall of Fame & Museum Conference Center, 1152 Lakeland Drive, Jackson, Mississippi. Registration will begin at 9:00 a.m. with the meeting to begin at 9:30 a.m..

During the February meeting, we will discuss in detail the newly released Final Rules issued by the CFPB related to the Ability-to-Pay, the Qualified Mortgage, Mortgage Loan Originator Compensation, High Cost Mortgage and new requirements related to loan servicing, appraisal rules and escrows. This stands to be the most ambitious meeting we have ever held.

As always, the dress code for this occasion is casual, and lunch will be provided. We ask that you fax or e-mail your registration to Liz Crabtree no later than Friday, February 15, 2013 so that arrangements for lunch can be finalized. We look forward to seeing you there.

<Ed Wilmesherr>

MRCG COMPLIANCE CALENDAR

01/16/09 – RESPA Servicing Transfer Disclosure revised	08/22/10 – Reg. E rules on gift certificates and gift cards effective
07/30/09 – Reg. Z early disclosures for dwelling secured loans effective	10/01/10 – Escrow requirements effective for mobile homes
08/20/09 – Reg. Z changes on time to make payments on open-end accounts effective	10/01/10 – S.A.F.E. Act regulations effective
08/20/09 – Reg. Z changes on notices of changes in terms on credit card accounts effective	01/01/11 – Risk-based pricing rules effective
10/01/09 – Reg. Z higher priced mortgage loan regulations effective	01/31/11 – S.A.F.E. Act Registration Begins
10/01/09 – Reg. Z servicing practices regulations effective	02/28/11 – Post Revised Notice to IOLTA Customers
10/01/09 – Reg. dwelling secured advertising disclosures changes effective	04/01/11 – Appraisal Independence Final Rule Effective
10/01/09 – HMDA changes for reporting rate spreads on higher priced mortgage loans effective	07/21/11 - Anticipated Effective Date for changes to Risk-based pricing notices
10/01/09 – Reg. Z HOEPA changes on verification of repayment ability effective	07/29/11 - S.A.F.E. Act Registration Expires
11/20/09 – Reg. Z disclosures on transfer of mortgage loans effective	02/21/13 – MRCG Quarterly Meeting
01/01/10 – RESPA GFE and HUD-1 disclosure changes effective	04/18/13 - MRCG Steering Committee Meeting
01/01/10 – Reg. DD changes on disclosure of OD fees and providing balance information effective	05/23/13 - MRCG Quarterly Meeting
02/14/10 – Reg. Z disclosures on private education loans effective	06/01/13 – Escrow accounts for higher-priced mortgages expands to 5 years
02/22/10 – Reg. Z implementing changes to open-end credit and credit card accounts under Credit Card Act effective	07/18/13 - MRCG Steering Committee Meeting
02/27/10 – Reg. CC disclosure changes effective	08/15/13 - MRCG Quarterly Meeting
04/01/10 – Escrow requirements effective for site-built homes	09/19/13 - MRCG Steering Committee Meeting
06/01/10 – Unlawful internet gambling enforcement regulation compliance date.	11/21/13 - MRCG Quarterly Meeting
07/01/10 – Reg. E changes for ATM and debit card overdrafts	01/10/14 – Multiple Final Rules issued by CFPB become effective
07/01/10 – FFIEC Accuracy and Integrity Guidelines effective	