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

QUARTERLY REPORT

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TO QUALIFY OR NOT TO QUALIFY
(That is the question)

In recent discussions with numerous compliance officers, it seems clear that many banks are struggling with the issue of whether or not they will seek to originate Qualified Mortgages. More particularly, banks are expressing some confusion about whether they will originate certain dwelling-secured loans that do not meet the definition of a Qualified Mortgage, and perhaps originate other loans that do satisfy Qualified Mortgage requirements.

The CFPB has recently released a Small Entity Compliance Guide to the Ability to Repay (ATR) Rule and the Qualified Mortgage (QM) Rule. While helpful, this Guide falls far short of setting forth a road map to compliance. Large and smaller banks, both, must come to grips with the issues surrounding the Ability to Repay Rule and make their own decision about whether they will choose to originate Qualified Mortgages.

It can't be emphasized enough: Each bank must make its own informed decision regarding these issues. The risks are great; the policies and procedures may be complicated and expensive; and one size will not fit all.

At the request of the Steering Committees of both the MRCG and the MSRCG, we will undertake to outline the road map a bank can follow to reach its own particular destination. The road is long and the time is growing short. So, let's begin.

Any discussion with Management and the Board of Directors regarding ATR and QM must start with an understanding of the risks that are involved. These risks cannot be ignored, nor can they be avoided. If the bank makes dwelling-secured loans (other than HELOC's and construction loans), it will have to satisfy the ATR. If it fails to satisfy the ATR, it will incur the following possible consequences:

- A $4,000 penalty for every loan that violates the ATR;
- Possible class action liability up to $1 million;
- Forfeiture of all fees and finance charges collected during the first three years of the loan;
- Payment of the consumer's attorney's fees (and those of the bank);
- Use by a consumer of a violation of the ATR as a defense at any time to a collection or foreclosure action;
- Possible claims by trustees in bankruptcy; and
- Criticism from the bank regulators.

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Regardless of whether plaintiffs' lawyers or trustees in bankruptcy ever take some action against the Bank, your regulator(s) will surely question the level of risk you have in your dwelling-secured loan portfolio. If that risk is elevated, your compliance risk profile will be adversely affected. That could impact your compliance rating, which could impact one or more of the elements of your CAMELS rating. An adverse impact on the CAMELS rating could affect the level of capital regulators feel that you should carry. These issues could impact profitability, which could in turn impact the perceived value of the Bank in a sale or merger transaction. So, it is easy to see why these decisions are so important.

Management needs to understand that there is no way to avoid the ATR. It is part of the Truth In Lending Act and Regulation Z and applies to every dwelling-secured loan except HELOC's and construction loans (the Truth In Lending Act prohibits structuring all loans as HELOC's to avoid compliance). The ATR requires you to underwrite each dwelling-secured loan using the following criteria:

- Income and assets;
- Current employment status (if income from employment is relied upon);
- Monthly payment on the covered loan;
- Monthly payment on any simultaneous loan;
- Monthly payment for mortgage-related obligations;
- Current debt obligations, alimony and child support;
- Monthly debt-to-income ratio; and
- Credit history

In a companion article, we will delve into the additional guidance that the CFPB has put forth related to these underwriting criteria, the processes for verifying each one, and the challenges associated with documenting this information. For decision making purposes, Management and the Board of Directors simply need to understand that this is an "every loan" process. Every dwelling-secured loan originated must comply with the ATR requirements and these eight underwriting factors.

So far, Management and the Board of Directors has not had a decision to make. They simply need to understand the requirements of the ATR and the risks associated with non-compliance.

But now, it is decision time. The Bank can simply elect to continue making non-Qualified Mortgages (with balloon payments, etc.) and assume the risk that the Bank will be able to prove its compliance with the ATR using its consistently applied policies and procedures as well as its thorough documentation of all 8 underwriting criteria for each and every loan, or it could seek some level of protection by originating Qualified Mortgages.

The foregoing summarizes the risks of not originating Qualified Mortgages; the consequences of taking that path, no one knows.

So, if Management and the Board of Directors opt for the safer route, they will need to understand: (1) What a Qualified Mortgage is, and (2) what the impact of a decision to originate Qualified Mortgages will mean for the Bank.

Basically, a Qualified Mortgage is a dwelling-secured loan that does not:

- Allow negative amortization;
- Allow interest-only payments;
- Feature a balloon payment (with certain small creditor exceptions);
- Have a term longer than 30 years;
- Exceed the regulatory limits on points and fees (discussed below);

- Have a debt-to-income ratio determined through the underwriting process, greater than 43%.

The Qualified Mortgage must provide for regular periodic payments of substantially equal amount and must be underwritten using the monthly payment required for all mortgage-related obligations (e.g. insurance, taxes, etc.) and the maximum interest rate applicable in the first five years of the mortgage loan. Periodic payments of principal and interest needed to repay the loan must be used.

You will still be required to consider, verify and document the applicant's income and assets using third party documentation, and current debts (including alimony and child support) will have to be similarly considered.

Two important issues will have an impact on bank profitability. The first is the points and fees limits for a Qualified Mortgage. To be a Qualified Mortgage, a dwelling-secured loan cannot have total points and fees that exceed:

- Loans greater than $100,000 – 3% of the total loan amount;
- Loans greater than $60,000, but less than $100,000 – $3,000;
- Loans greater than $20,000, but less than $60,000 – 5%;
- Loans greater than $12,500, but less than $20,000 – $1,000; and
- Loans less than $12,500 – 8%

This requirement will obviously involve an assessment of the fees and points the Bank currently charges.

The second point of impact comes as a result of which level of protection the bank wants to have when it originates Qualified Mortgages. The Qualified Mortgage Rule provides two different levels of protection for Qualified Mortgages: (1) a "safe harbor"; or (2) a presumption of compliance. Eligibility for one or the other is determined by the pricing of the loan. A "higher-priced" loan (i.e. one with a rate greater than 1.5% above the average prime offer rate) will only have a presumption of compliance. Loans with rates that do not exceed 1.5% above the APOR receive "safe harbor" treatment. A "safe harbor" loan supposedly cannot be challenged for compliance with the ATR. A loan with only a presumption of compliance could see that presumption rebutted.

A final issue for Management and the Board to consider is the question of balloon payment loans. Many banks have used balloon payment loans as a method of managing interest rate risk for decades. Now, however, balloon payment loans generally will not qualify as Qualified Mortgages. So, many Banks will have to develop other products, perhaps adjustable rate mortgages, that can substitute for balloon payment loans. You should ask whether your bank will need to develop new loan products.

Management and the Board of Directors should be aware of the so-called Small Creditor Exception to this general prohibition against balloon payment loans. To qualify, a Bank must have total assets less than $2 billion. It must originate no more than 500 covered loans annually, and 50% or more of those loans must be made in "rural" or "under-served" counties.

If the Bank clears those hurdles, then it could originate balloon payment loans so long as those loans do not have a term that exceeds 30 years, feature a fixed rate of interest and have a term of 5 years or longer.

Ask yourself first whether the Bank qualifies, and ask second what the effect on the Bank would be to originate dwelling-secured loans with the features described above.

After going through this exercise, Management and the Board of Directors should have an idea of which path they wish to choose. It is even conceivable that the Bank might choose to originate both Qualified Mortgages and non-Qualified Mortgages. However, either choice will

entail a major effort to modify underwriting practices, create verification of information processes, establish documentation procedures and provide for monitoring of all of the above. Management and the Board of Directors must understand how much time, effort and expense will be involved and that short cuts won't exist. The time to begin this process is now. The January, 2014 deadline for compliance is fast approaching.

We will devote a significant portion of the May Quarterly Meeting to the ATR and the QM Rules and their implementation.

(Ed Wilmesherr)

THE MORTGAGE SERVICING RULES AND THE SMALL SERVICER EXCEPTIONS

The CFPB's final rules implementing the Dodd-Frank provisions regarding mortgage loan servicing will take effect January 10, 2014. That date is not as far away as it may seem. In order to determine what to tackle first, we need a good working knowledge of the requirements of the regulations and an understanding of when and to whom those requirements apply.

As we all know by now, the rules are complicated and contain many specific and technical requirements. Importantly for many community banks, however, the rules also include several exemptions and exceptions from some requirements for small servicers. In this article, we will take a look at the coverage of the new rules, the definition of "small servicer," the particular requirements that apply to a small servicer, and, then, the additional requirements that apply to all other servicers.

Coverage. You will recall from our discussion in February that the servicing rules amend both Regulation X (RESPA) and Regulation Z (Truth in Lending). The amendments to Reg. Z apply to any dwelling secured closed-end consumer credit transaction, which could be a first or subordinate lien and may or may not involve the borrower's principal dwelling. The Reg. Z changes include three new rules: ARM loan adjustment disclosures; periodic billing statements; and prompt payment crediting and payoff statements. The prompt payment crediting and payoff statement requirements also apply to open-end consumer HELOCs. The Reg. Z rules apply to the loan's servicer, the creditor, if it still owns the loan, and to any assignee that has purchased and still owns the loan. This means that while only one of those parties has to comply, any of them can be liable for a violation. The one exception is the rule for prompt payment crediting which only applies to the servicer. Of course, in many cases, the servicer and creditor or owner of the loan will be one and the same.

The Reg. X amendments apply to any "mortgage loan" which is defined as a "federally related mortgage loan" covered by RESPA, subject to the usual RESPA exemptions for business purpose loans, loans secured by 25 acres or more, and construction or other temporary financing, and excluding, in this case, HELOCs. The Reg. X amendments include six new rules: force placed insurance, error resolution and information requests, servicing and information management policies and procedures, early intervention with delinquent borrowers, continuity of contact with delinquent borrowers, and loss mitigation procedures. With a couple of exceptions, the Reg. X servicing amendments will apply to a first or subordinate lien "mortgage loan." The existing RESPA requirements for an initial servicing disclosure and for servicing transfer disclosures will continue to apply only to a first lien mortgage loan. The requirements for early intervention with delinquent borrowers, continuity of contact with delinquent borrowers, and loss mitigation procedures apply only to a mortgage loan secured by the borrower's principal residence.

Small Servicer Defined. As noted above, the Reg. Z amendments apply to loan servicers, creditors and assignees, but there is an exemption from some requirements for a "small servicer" defined as a servicer that, together with any affiliates: (i) services 5,000 or fewer mortgage loans in a

calendar year, and (ii) only services mortgage loans that it or its affiliate either originated or now owns. The number of mortgage loans being serviced is determined as of January 1 each year and is good for the rest of that year. A servicer that crosses the 5,000 threshold for the first time will have until the later of 6 months after crossing the threshold or the next January 1 to comply with any requirements for which it is no longer exempt. As a side note, the CFPB has just published proposed amendments to the new servicing rules to clarify the types of loans that must be counted in evaluating the 5,000 loan threshold. The proposal would clarify the small servicer definition and exclude timeshares and reverse mortgages as well as loans serviced on a pro bono basis for an unaffiliated entity, such as Habitat for Humanity, from the threshold determination. The CFPB is also seeking comment on whether further clarification is needed with respect to the threshold calculation in light of the differences in coverage between RESPA for federally related mortgage loans and Reg. Z for all dwelling secured loans.

Small Servicer Exceptions. There are several exemptions and exceptions to the Reg. Z and Reg. X amendments available to loans serviced by a "small servicer" as that term is defined in Reg. Z. First, creditors, assignees and servicers are exempt from the Reg. Z requirements for billing statements or payment books on loans serviced by a small servicer. Second, small servicers are exempt from the Reg. X requirements to develop and maintain written loan servicing and information management policies and procedures. Third, small servicers are exempt from the Reg. X requirements for early intervention with delinquent borrowers, continuity of contact with delinquent borrowers, and loss mitigation procedures, except that small servicers are subject to the prohibition against publishing or filing for foreclosure until the loan is at least 120 days delinquent. Finally, small servicers are exempt from the rule prohibiting the servicer from force placing insurance in situations where hazard insurance premiums are paid through an escrow account and the servicer can advance funds to pay the premium, but only if the force-placed insurance is less expensive to the borrower than the amount the servicer would have to disburse to maintain the borrower's existing hazard insurance. Small servicers remain subject to the notice and other requirements for force-placed insurance.

Servicing Requirements for All Servicers Including Small Servicers. Even after taking into consideration the exemptions and exceptions, small servicers still have a substantial compliance burden. The mortgage servicing requirements applicable to all mortgage loan servicers, including small servicers, are as follows:

- Prompt payment crediting and payoff statements. Servicers must promptly credit a "periodic payment" as of the day it is received. A payment in an amount sufficient to pay principal, interest, and escrows (if applicable) is considered to be a "periodic payment" whether or not it is also sufficient to cover any late charges, other fees or non-escrow payments a servicer has advanced. If the payment is less than a "periodic payment", the servicer can apply it or hold it in a suspense account. Once the amount in the suspense account is enough to cover a periodic payment, it must be applied as of that date to the consumer's loan 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 are responsible for providing an accurate payoff balance to a consumer within a reasonable time, no later than seven business days, after receiving a written request.

- ARM adjustment notices. Currently, Reg. Z requires that a consumer be given notice of an interest rate adjustment for an ARM loan at least 25 but no more than 120 days before a payment at the new payment amount is due. The new amendments will require earlier and more detailed notices.

Servicers, including creditors and assignees, must provide the consumer with the first adjustment notice at least 210 but no more than 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. The notice must be in a separate and dated disclosure document. The requirements for the content of the notice are detailed and lengthy. The disclosures should be in the form of a table and in the same order and format as the model disclosures in the rule. Some information is required to appear outside and above the table.

The content of the required notice includes: an explanation that the current interest rate period is ending and a change in the interest rate may result in a change in the mortgage payment; the effective date of the rate adjustment and when additional rate adjustments are scheduled to occur; any 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 current and new interest rate; current and new payment amount; date the first new payment is due; for interest only or negatively amortizing payments, an explanation of how the current and new payment is allocated to principal, interest and escrows; an explanation of how the rate is determined (the index used, a public source of information for the index, and any margin added to the index); any limits on rate or payment increases at each adjustment period and over the life of the loan; an explanation of how the new payment amount is determined (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, the estimates must be based on a current index and include 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 reduce the loan balance; for negatively amortizing payments, a warning that the new payment will add to the loan balance, and the payment amount required to amortize the loan balance at the new interest rate over the remaining loan term; any prepayment penalty and a statement that the consumer may contact the servicer for more information; a telephone number the consumer may 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, or requesting a modification or payment forbearance; CFPB or HUD website addresses and HUD toll-free telephone number that may be used to obtain a list of approved counselors; and the CFPB website to find contact information for state housing finance authorities.

For subsequent rate adjustments, a similar notice must be provided between 60 and 120 days before a payment at a new level becomes due. The current Reg. Z requirement for a notice to the consumer at least once each year in which an interest rate adjustment is made but that does not result in a corresponding change in payment amount has been eliminated.

- Force-placed insurance. Under Reg. X, before a servicer can charge the borrower for force-placed insurance, the servicer must have a reasonable basis to believe the borrower has failed to maintain hazard insurance. In order for a reasonable basis to be established, the servicer must send two written notices to the borrower and not have received any verification that the borrower has insurance coverage in place. The first notice must be sent at least 45 days before a charge is imposed, and a second reminder notice must be sent 30 days or more after the first notice and at least 15 days before a charge is imposed. Before force-placed coverage can be renewed, a notice must be sent before the anniversary date of the force-placed policy and at least 45 days before a charge is imposed for the renewal coverage.

The rule prescribes the content and format of the notices and contains model forms. Some information must appear in bold text. The notices must be in a separate document, but 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 and refund any premiums for overlapping coverage within 15 days. All charges must be bona fide and reasonable. Any costs

other than premiums or charges regulated by state insurance authorities or authorized by Federal law for flood insurance, must be for services actually performed and bear a reasonable relationship to the servicer's cost of providing the service.

When the loan includes escrows for payment of insurance, the servicer will be required to advance funds to pay the hazard insurance premiums even where the borrower is delinquent on the loan. Currently, RESPA requires a servicer to advance escrow funds only if the borrower is not more than 30 days past due. There is an exception for situations where the servicer has a reasonable basis to believe the borrower's policy was cancelled or not renewed for reasons other than non-payment of the premium or where the borrower's property is vacant.

Small servicers are exempt from the requirement to advance funds where the insurance premiums are paid through an escrow account, but only if the force-placed insurance is less expensive to the borrower than the amount the servicer would have to disburse to maintain the borrower's existing coverage. Small servicers are not exempt from the notice and other requirements for force-placed insurance.

- Error Resolution and Information Requests. The Reg. X amendments define a servicer's obligations to correct errors and respond to consumer requests for information and set time limits for responding. In order to trigger the time limits, the notice of error or information request must be in writing, and servicers can designate a specific address to be used for that purpose by written notice to the consumer.

Servicers must acknowledge receipt of the request or error notice within five days (excluding Saturdays, Sundays and legal holidays), investigate and correct the error and any additional errors discovered in the course of investigation, and provide the borrower with written notice of the corrective action taken along with contact information including a phone number the consumer can use for further assistance. If the investigation finds that no error occurred, then the notice must include a statement of reasons 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 additional information from the borrower in connection with the investigation, but may not postpone starting its investigation or use the failure to receive additional information as a reason for determining no error occurred without conducting an investigation to the extent possible.

Time limits for responding to a notice of an error include: failure to provide a payoff statement – 7 days after receipt; errors relating to initiating foreclosure, seeking a judgment or order of foreclosure, or conducting a foreclosure sale in violation of the rule – earlier of prior to foreclosure or within 30 days after receipt of notice; and for other errors - 30 days after receipt. For errors other than payoff statements and foreclosure, the servicer can extend the 30 day period to 45 days by written notice to the borrower of the reasons for the extension. If the borrower requests copies of any documentation relied upon by the servicer, it must be provided at no charge to the borrower within 15 days after request. The servicer can withhold privileged, confidential or proprietary information but must give written notice to the borrower within 15 days after receipt of the borrower's request.

The servicer can short-cut the investigation process simply by correcting the error asserted by the borrower and notifying the borrower within 5 days after receiving the borrower's notice. There are also exceptions to the investigation requirements 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 servicing has been transferred elsewhere. However, when an exception applies, the servicer must respond to the borrower's notice within 5 days telling the borrower the reason no investigation will be made.

No fee can be charged for responding to an error notice. Servicers cannot require any payment due or past due to be made before responding to an error notice. Any adverse information about the account that relates to a payment that is the subject of an error notice may not be furnished to a consumer reporting agency for at least 60 days after receipt of the error notice. The servicer is generally free to pursue collection or foreclosure for delinquent accounts while responding to an error notice, unless the error notice relates to a violation of the rules concerning foreclosure.

Requests for information are required to be treated in the same way. Within similar time deadlines, a servicer must acknowledge receipt of the borrower's request and either provide the information or explain why it is not available. The requirements in current Reg. X for responding to a "qualified written request" go away. That term still exists under the new rules, but a qualified written request is just one type of error notice or request for information and is subject to the same rules and deadlines.

- Foreclosure. A small servicer may not initiate foreclosure (publish the first notice or make the first filing required for a foreclosure) unless the borrower is at least 120 days delinquent. In addition, a small servicer may not seek to a judgment of foreclosure, move for an order of sale, or actually conduct a foreclosure sale, if the borrower is performing pursuant to the terms of a loss mitigation agreement.

Additional Requirements for Servicers Other Than Small Servicers. In addition to the above requirements, a servicer who does not meet the definition of a small servicer must also comply with the following additional rules:

- General servicing and information management policies and procedures. Servicers must establish and maintain written policies and procedures for servicing loans and maintaining and managing information. The policies and procedures must be tailored to the size, scope, and nature of the servicer's operations and be reasonably designed to achieve five main objectives:
  - accessing and providing accurate and timely information to borrowers, investors, and courts (which might include policies and procedures for providing accurate and timely disclosures, responding to error notices and information requests, providing mortgage investors and assignees with loan information, handling of foreclosures and foreclosure documentation, and handling loans where the borrower has died);
  - properly evaluating loss mitigation applications (policies and procedures for making borrowers aware of loss mitigation options, identifying the options a borrower may be eligible for, identifying the information a borrower must submit for consideration, ensuring all personnel assisting the borrower have access to the information, and evaluating the borrower's application under investor guidelines and required RESPA loss mitigation procedures);
  - oversight of third party service providers (policies and procedures for appropriate access to information concerning servicer provider actions, periodic reviews/compliance audits of the service provider, and facilitating sharing of information between the servicer and the third party service provider in connection with any loss mitigation or foreclosure proceedings);
  - transfer of information in servicing transfers (policies and procedures for assuring complete and accurate information is transferred or received, as the case may be); and
  - making borrowers aware of error resolution and information request procedures.

In addition, servicers must meet two basic standards for information management: (i) servicing records must be maintained for at least one year after the payoff or transfer of servicing of the loan; and (ii) records and data for each mortgage loan must be maintained in a way that would allow the servicer to compile it into a loan

servicing file within five days that includes a schedule of all transactions on the account including any escrow or suspense accounts, a copy of the mortgage or deed of trust, any notations by servicing personnel reflecting communications with the borrower about the account, 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.

There is a safe harbor for compliance with the policies and procedures rule that protects a servicer who does not engage in a pattern or practice of failing to achieve any of the five objectives or failing to ensure compliance with the two standard requirements.

- Early Intervention with Delinquent Borrowers. For a loan secured by the borrower's principal dwelling, a servicer must make good faith efforts to establish live contact with the borrower by the time the account is 36 days delinquent and inform the borrower, where appropriate, that loss mitigation options may be available. In addition, the servicer must send written notice by the time the loan is 45 days delinquent. The notice must include, among other things: a statement encouraging the borrower to contact the servicer; the servicer's telephone number; a brief description of any available loss mitigation options; and information about how to contact approved counseling organizations. The rules specify the contents of the written notice and provide model forms.

- Continuity of contact with delinquent borrowers. For a loan secured by the borrower's principal dwelling, a servicer must have and maintain reasonable written policies and procedures for providing the delinquent borrower with access to personnel who can assist them with any available loss mitigation options. The policies and procedures must be reasonably designed to: assign the borrower to specific loss mitigation personnel by the time written notice under the early intervention requirements is given, but no later than 45 days after delinquency; make the assigned personnel accessible to the borrower by phone; provide the borrower with accurate information about available loss mitigation options and the documents and information required to evaluate the borrower for eligibility; and ensure that the assigned personnel and any others responsible for evaluating the borrower for loss mitigation options can access all information the borrower has provided to the servicer.

- Loss Mitigation Procedures. For a loan secured by the borrower's principal dwelling, a servicer is subject to limitations on initiating or continuing foreclosure and to procedural requirements when offering loss mitigation options. A loss mitigation option is pretty much any alternative to foreclosure that is offered by the investor/owner of the mortgage loan that is available through the servicer. The rules do not require servicers to make any specific loss mitigation options available, but if they do, the servicers must follow the procedures described in the rules. Servicers are also free to follow the requirements and guidelines established by the investor to determine eligibility.

  - Foreclosure and dual tracking. As noted above, servicers are prohibited from starting foreclosure until the loan is at least 120 days delinquent. Once a borrower is more than 120 days past due, the servicer can start foreclosure unless the borrower has submitted a complete loss mitigation application. In that event, the servicer must complete the review and appeal process required in the procedures described below before starting foreclosure. Additionally, if the borrower submits a complete loss mitigation application by the deadlines discussed below, the servicer may not seek a judgment for foreclosure, move for an order of sale or conduct a sale until the review and appeal process is complete. Also, as noted above, a servicer may not start foreclosure if the borrower is performing under a loss mitigation agreement, and may not seek a judgment for foreclosure, move for an order of sale or conduct a sale if the borrower is performing under a trial modification or other

agreed loss mitigation option. In other words, the rules prevent a servicer from "dual tracking" – proceeding with foreclosure while at the same time dealing with the borrower on a pending loss mitigation option.

- Loss mitigation applications and timelines. For any loss mitigation application received 45 days or more prior to a foreclosure sale, the servicer must acknowledge receipt in writing within five days and inform the borrower of any additional information needed to complete the application and the deadline for providing it. If a complete loss mitigation application is received more than 37 days before a foreclosure sale, the servicer must evaluate the borrower for all available loss mitigation options within 30 days.

- Approvals. If a complete loss mitigation application is received 90 days or more before a foreclosure sale, the servicer must give the borrower at least 14 days to accept or reject any offer of loss mitigation. If the application is received less than 90 but more than 37 days before a foreclosure sale, the borrower must be given at least 7 days to accept or reject any loss mitigation offer. If the borrower does not accept within the applicable timeframe, the servicer can treat the offer as rejected, subject to the appeal rights discussed below.

- Denials and review of denials. If the application is denied, written notice of that determination must be given to the borrower. If the application is for a trial or permanent loan modification and is denied, the servicer must give specific reasons for its decision for each available modification program. If the application for modification was received 90 days or more before a foreclosure sale, the borrower may appeal the denial, and the denial letter must also describe the borrower's right to appeal, the deadline for doing so (which must be at least 14 days after providing the denial notice) and any requirements for the appeal. The appeal must be reviewed by different personnel than those responsible for evaluating the original application. The servicer must notify the borrower of its determination on the appeal within 30 days. If the appeal results in an offer of loss mitigation or there was a pending offer at the time of the appeal, the borrower must be given 14 days after the servicer provides notice of its determination on the appeal to accept or reject. Additional appeal rights are not required.

- Periodic billing statements. The Reg. Z amendments require servicers, creditors and assignees to provide a periodic statement for each billing cycle on a dwelling secured consumer loan. Billing statements must meet the timing, form, and content requirements provided in the rule, and the rule includes model forms. On fixed rate loans, the servicer may provide a coupon or payment book in lieu of sending billing statements. In that case, the rule specifies the content of the payment book. Reverse mortgages and timeshare plans are exempt as are loans serviced by a small servicer.

The information required to be contained in the periodic statement includes: the amount and due date; any late charge and the date it will be imposed if payment is not received; a breakdown of the payment as to principal, interest, escrow, fees and any past due amount; payments received since the last statement and how the payment was applied; the total of payments received since the beginning of the calendar year and how that total was applied; any debits or credits to the account during the statement period; an explanation of any partial payments held in suspense or unapplied and what must be done for the funds to be applied; account information such as principal balance, current interest rate, next interest rate change date, and any prepayment penalty; contact information for the servicer; CFPB or HUD website addresses and the HUD toll-free telephone number that may be used to obtain a list of approved counselors; on a loan more than 45 days past due, the date the delinquency occurred, possible risks including foreclosure, and a history of the account since it was last current (up to 6 months' worth of history),

an indication of any loss mitigation program the consumer has agreed to, notice of whether the servicer has started foreclosure, the amount needed to bring the loan current, and a reference to the availability of homeownership counseling.

If payment coupon books are used, each coupon must contain: the payment due date and amount and any late charge and the date it will be imposed if payment is not received. In addition, the book must include information about the account such as principal balance, current interest rate, next interest rate change date, any prepayment penalty, contact information for the servicer, and information about how the consumer can obtain additional information.

Civil Liability. In the past, banks have been subject only to administrative enforcement actions by the bank regulators for most RESPA violations. However, with two particular exceptions, borrowers will have a private cause of action for violations of the new servicing requirements under either or both Reg. X and Reg. Z. In issuing the Reg. X amendments, the CFPB is relying on its authority under Section 6 of RESPA, as amended by Dodd-Frank. Borrowers have a private cause of action for violations of Section 6 and may sue 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. The exceptions are the rules requiring written servicing and information management policies and procedures and the rules requiring continuity of contact with delinquent borrowers which do not carry with them the risk of a private cause of action for violations. Violations of the Reg. Z requirements are subject to the usual civil liability provisions for violations of the Truth in Lending Act. So, there is the potential for considerable liability for violations of the new servicing requirements. In particular, the requirements for early intervention with delinquent borrowers and the foreclosure limitations and loss mitigation procedures may give borrowers a significant potential claim or defense to use in connection with mortgage foreclosures. And, of course, the CFPB and the prudential bank regulators have authority over servicers within their jurisdiction to bring enforcement actions to assure compliance with all of the new requirements.

Implementation. The CFPB has said it will issue guidance to assist the mortgage servicing industry implement the new rules by the January 10, 2014 effective date, but that guidance has not been forthcoming thus far. And, if the CFPB guidance on the ability to repay rule is any indication, any guidance on the servicing rules, while helpful, will likely not be a detailed how-to manual. Small servicers will need to review existing policies, procedures, and processes and make changes and consider new controls for assuring compliance with the timing requirements for responding to error resolution and information requests, providing force-placed insurance notices and assessing charges, and for initiating foreclosure. Prompt crediting of payments is not a new requirement and it is likely you already have procedures in place. Larger servicers will have a much bigger burden. Establishing detailed policies and procedures including loss mitigation procedures will likely require a significant investment in time and require extensive staff training. Producing billing statements or coupon books will require programming and systems changes and testing of those changes, things which usually require long lead times. Hopefully, you have already begun.

(Cliff Harrison)

CFPB ISSUES SMALL ENTITY COMPLIANCE GUIDE

On April 10, 2013, the CFPB released its Small Entity Compliance Guide to the Ability to Repay and Qualified Mortgage rules. The Guide leaves much to be desired when it comes to comprehensive guidance regarding compliance with these two rules; however, it does contain a number of "implementation tips" that are useful to know. The following are some of the most helpful tips.

The Ability to Repay

- Modification v. Refinancing. The Guidance points out that the Truth in Lending Act does not apply to a modification of an existing loan; it only applies to refinancings. A workout loan might be a modification and might not be subject to Truth in Lending. If Truth in Lending does not apply, then neither does the ATR. But remember, the substitution of a new obligation in place of an old obligation will always be subject to Truth in Lending requirements, and an upward adjustment in interest rate will take the transaction out of the status of a modification. At first blush, this approach seems to offer a solution to the problem of existing balloon loans that will mature after January, 2014. However, these loans were originated as balloon loans to deal with interest-rate risks, and interest rates will almost surely be on the increase in the not too distant future. Whether this tip proves very useful or not will remain to be seen.

- Policies and Procedures. It goes without saying that every bank will need to evaluate and revise their loan underwriting policies and procedures to document that each of the eight underwriting criteria required by the ATR are taken into account. Remember that this requirement will apply regardless of whether your bank chooses to originate Qualified Mortgages or not. This is a logical starting point for your entire ATR/QM compliance process.

- Verification of Income and Employment. The Guidance takes the reasonable position that you only need to verify and document sufficient income and assets to determine an applicant's ability to repay. If there are multiple sources of income, but one source by itself is sufficient, that source alone is all you would need to verify. You can verify employment in a conversation with the applicant's employer, but remember that you must document your conversation. The CFPB takes the position that you don't have to retain a paper documentation trail, but you must be able to reproduce your records accurately.

- Reasonably Reliable Third-Party Records. The Guidance provides a helpful list of reliable records. None of these will be a surprise, but it could serve as a list of records to include in your underwriting policy. It goes on to offer a tip: when a consumer lists a debt on his or her application that does not appear on the credit report you pull, you must include the debt in your debt-to-income calculation, but you do not have to verify that debt.

- Verifying Income, Assets, Employment and Credit History. You only need to verify what is relied upon to determine ATR. However, all eight criteria must be addressed. If two consumers apply, you do not have to verify both incomes, unless both incomes are needed to qualify for the loan. Seasonal income, bonuses or future income can be relied upon if verified by reasonably reliable third-party records. Self-employment income should be supported by a third-party accountant's verification of that income.

- Credit History. If a credit report shows a dispute or a fraud alert, you can disregard the disputed information.

- Debt-To-Income Calculation. You should include in a consumer's total debt figure all ongoing, required monthly, quarterly or annual debt payments of the consumer. Do not include any debts that will be paid off as a part of your loan closing. If the debt has a variable interest rate feature, use the greater of the fully-indexed rate or any introductory rate. Remember that the debt-to-income calculation must be based on substantially equal monthly payments that would fully amortize the debt. If a balloon payment is involved, use the maximum payment scheduled in the first five years for a non-higher-priced loan, or the balloon payment itself for a higher-priced loan. Payments are "substantially equal" if no two payments vary by more than 1%. If a

HELOC is involved as a simultaneous loan, you would calculate that monthly payment using the amount to be drawn against the line at the time of closing.

- Debt Obligations. You do not have to consider or verify the debt obligations of someone who is merely a guarantor or surety for the loan.

The Qualified Mortgage

- Safe Harbor v. Rebuttable Presumption of Compliance. For a higher-priced Qualified Mortgage, there would only be a rebuttable presumption of compliance. If the consumer could show that, based on the information you had when the loan was made, the consumer did not have enough residual income left to meet living expenses after paying their mortgage and other debts, the presumption of compliance would be rebutted. If the Qualified Mortgage is not higher-priced, the consumer has no recourse and the bank has its safe harbor. The rebuttable presumption provides more legal protection than simply complying with the general Ability To Repay requirements, but less protection and certainty than the safe harbor.

- Use of Credit Report for Qualified Mortgage. Although consideration and verification of a consumer's credit history are not specifically a part of the definition of a Qualified Mortgage, you do have to consider the consumer's debt obligations using reliable third-party records, which may include a credit report or nontraditional credit references.

- Calculating Points and Fees. The calculations here are the same as they would be for a HOEPA loan. You must include all amounts known at or before loan closing, even if they are paid at or after closing by rolling them into the loan amount. Six categories of charges must be added together:

1. Finance Charge. All items of finance charge will be included except for:
   - Interest;
   - Mortgage insurance premiums (FHA, VA, etc.);
   - Private mortgage insurance premiums (PMI) (Note: you must include any amount of PMI that exceeds the up-front MIP for FHA loans);
   - Bona fide third-party charges not retained by the creditor, loan originator or any affiliate (e.g., attorney's closing fees, etc.);
   - Bona fide discount points (up to 2 points for loans that do not exceed the APOR by more than 1%; up to 1 point so long as the rate before the discount does not exceed the APOR by more than 2%.) (Note: To be "bona fide" the discount must reduce the rate by an amount that reflects industry norm for secondary mortgage transactions.)

2. MLO Compensation. You must include amounts paid directly or indirectly by either the consumer or the creditor to a loan originator (e.g., a broker or retail loan officer). Include the following:
   - Compensation paid directly by the consumer;
   - Compensation paid by the bank to a broker;
   - Compensation paid by the bank to its loan officer for originating the loan.

3. Real Estate-Related Fees. Provided the charges are reasonable and neither the bank nor an affiliate retains any portion of the charges, you can exclude the following from the points and fees calculation:

- Fees for title work, title insurance, survey, etc.;
- Fees for document preparation;
- Notary and credit-report fees;
- Appraisal or inspection fees (including pest and flood-hazard determination);
- Amounts paid into escrow that are not included in the finance charge.

4. Premiums for Credit Insurance; Credit Property Insurance; Other Insurance Where the Bank is the Beneficiary; and Debt Cancellation Products.

5. Maximum Prepayment Penalties; and

6. Prepayment Penalty Paid in a Refinance Transaction.

- Prepayment Penalties. Prepayment penalties are not totally prohibited, but can only be charged for fixed-rate or step-rate Qualified Mortgages that are not higher-priced. Note that bona fide third-party charges that were waived at closing (but were expected to be recovered through the interest rate over time) can be recouped if the consumer prepays during the first three years, and not be counted as a prepayment penalty.

  Prepayment penalties can only be charged during the first three years of the loan and are limited to 2% during the first two years and 1% the third year.

  If you wish to charge a prepayment penalty, you must offer the consumer an alternative loan that he will qualify for which does not feature a prepayment penalty. That alternative loan must be a fixed-rate loan with the same term as the prepayment penalty loan. It cannot have negative amortization, interest only payments or balloon payments.

The foregoing is by no means a comprehensive guide to complying with the ATR or the origination of Qualified Mortgages, but it does provide a number of helpful pointers and will prove useful when it comes time to draft policies and procedures for ATM and QM compliance. We will address these points in greater detail at the May Quarterly Meeting.

(Ed Wilmesherr)

CFPB ISSUES CLARIFICATIONS REGARDING QUALIFIED MORTGAGES

When the CFPB issued its Qualified Mortgage Rule it provided for a standard Qualified Mortgage which will be a permanent form of Qualified Mortgage; however, it also provided for a temporary Qualified Mortgage that: (1) would meet the prohibitions on risky loan features (e.g., negative amortization and interest only features); (2) would not exceed the limitations on points and fees for a standard Qualified Mortgage; and (3) would either be eligible for purchase or guarantee by FNMA and GNMA (the GSE'S) or be insured or guaranteed by HUD, the VA or the USDA. This authority will lapse once the GSE's and other agencies develop their own Qualified Mortgage definitions; and this type of Qualified Mortgage will sunset seven years after the effective date of the rule, even if there is no action by those other agencies.

Responding to a number of criticisms, the CFPB has provided clarification that a loan does not have to actually be sold in the secondary market in order to be a Qualified Mortgage using this approach. Furthermore, a creditor does not have to comply with all GSE or agency requirements that apply to secondary market loan sales – only those GSE or agency requirements that relate to the consumer's ability to repay the loan. So, a creditor can use the GSE's and agency's general standards concerning borrower, product, and mortgage eligibility and underwriting while ignoring any requirements that are wholly unrelated to assessing ability to repay and other risk-related factors. For instance, your bank would not have to be FNMA or GNMA approved,

or even eligible, to use this Qualified Mortgage alternative. In all, this approach makes this alternative somewhat attractive – at least in the short-run.

In a very practical move, the CFPB has also issued clarification regarding the application of Appendix Q to the Qualified Mortgage Rule which establishes standards for determining such things as monthly debt and income of an applicant.

Appendix Q was developed using existing FHA underwriting guidelines as a foundation. However, the CFPB has now determined that some of those guidelines may not function well in a regulatory setting.

For instance, Appendix Q, as proposed, required a determination that a consumer's income was "stable". The CFPB now has realized that employers are not likely to commit to an employee's continued employment for a host of reasons. Therefore, the CFPB has proposed to remove that requirement and substitute instead a requirement to document only a confirmation of current, ongoing employment. A consumer's employment can be considered ongoing if the employer verifies current employment and does not indicate that the consumer's employment is set to terminate.

Similarly, Appendix Q as proposed required a creditor to determine that a consumer's income could reasonably be expected to continue throughout the first three years of the loan and that overtime and bonus income would also likely continue. The CFPB now is of the opinion that such predictions are not practical and might increase a creditor's risk of litigation. So, the CFPB now proposes that a creditor only determine that a consumer's income would reasonably be expected to continue based on documents provided, with no three year requirement. Similar changes are proposed for bonus and overtime income.

In all, these clarifications are helpful and perhaps reflect an effort on the part of the CFPB to work with creditors in an effort to achieve a feasible level of compliance. This most recent clarification indicates that further guidance can be expected in the near future. We will continue to monitor those developments.

(Ed Wilmesherr)

THE CFPB'S TAKE ON INDIRECT AUTO LENDING

As further proof that the CFPB has Fair Lending as one of its top priorities, that agency has issued its CFPB Bulletin 2013-2 addressing compliance with the fair lending requirements of the Equal Credit Opportunity Act (ECOA) in the context of purchases of indirect contracts from automobile dealers. In particular, the CFPB addresses those banks and other regulated entities that purchase retail automobile contracts from dealers while allowing those dealers to increase a consumer's interest rate above what the bank (or other lender) establishes as the "buy" rate, or interest rate at which the lender commits to purchase the contract. The additional interest or up-charge is either retained by the dealer or split with the lender on some basis. This additional compensation is sometimes referred to as a "reserve" or "participation" charge. Sound familiar? It used to be a common practice, but it is unclear today how many banks currently purchase retail automobile paper, or allow for such up-charge practices.

Obviously, there is a serious prospect that discretion on the part of a dealer, in a situation such as that described above, might determine which consumers get higher interest rates and how much higher those rates might be. If the practice of allowing dealer up-charges should result in pricing disparities that can be linked to the race, national origin, gender or some other prohibited basis under ECOA, then discrimination might result. The doctrines of both disparate treatment and disparate impact would apply.

In its Bulletin, the CFPB takes the position that a bank or other lender who reviews an application and commits to purchase an automobile contract at a "buy" rate is a creditor for purposes of liability under ECOA. While contrary arguments can be made, it is a waste of time trying to argue

that point. If the practice exists at your bank, you need to assess the compliance risks involved.

The CFPB suggests taking the following steps:

- Imposing controls on dealer markup and compensation policies, or otherwise revising dealer markup and compensation policies, and also monitoring and addressing the effects of those policies so as to address unexplained pricing disparities on a prohibited basis; or

- Eliminating dealer discretion to mark-up buy rates and fairly compensating dealers using another mechanism, such as a flat fee per transaction.

The CFPB concludes its Bulletin by once again stressing the importance of a robust compliance management system when it comes to Fair Lending. That goes without saying.

This action by the CFPB further evidences that agency's focus on protecting consumers. It also demonstrates that the CFPB will use the full range of powers it possesses to provide that protection. Although automobile dealers succeeded in getting a carve-out from regulation under the Dodd-Frank act, the CFPB has drafted banks and other regulated lenders into the regulatory enforcement process to police automobile dealer practices. That approach may well continue in the future.

In a little-known provision in the Dodd-Frank Act, the CFPB is authorized to take enforcement action against any regulated lender that facilitates some other unregulated person, business, etc. in violating any of the consumer protection laws and regulations that the CFPB enforces. For instance, that authority could be used against a bank that has a line of credit to a car dealer that handles its own financing of automobile sales without selling the contracts directly to the bank. That line of credit might be unsecured, or might be secured by the sales contracts the dealer holds. Although no mention of that is made in Bulletin 2013-2, everyone would be well advised to be alert to activities that your customers engage in which your bank may be facilitating through lending or other traditional bank services. The CFPB is probably not through flexing all of its Fair Lending muscle.

(Ed Wilmesherr)

MLO QUALIFICATIONS AND COMPENSATION

The CFPB rules issued January 20, 2013, make substantial changes to Reg. Z in order to implement the Dodd-Frank provisions concerning loan originator compensation. However, the final rules do more than just that. They include loan originator qualifications, expand recordkeeping requirements, prohibit use of mandatory arbitration and the financing of single premium credit insurance and require the use of NMLRS unique identifier numbers on loan documents. The prohibitions on use of mandatory arbitration and financing single premium credit insurance become effective June 1, 2013, and the remaining rules become effective January 10, 2014. In this article, we will review each of the new requirements.

Definition of Loan Originator. The rule revises the definition of the term "loan originator" for purposes of the compensation and qualification rules. Currently, Reg. Z defines "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 the definition to cover any person who for direct or indirect compensation or other monetary gain, or in expectation thereof, does any of the following: takes an application, offers, arranges or assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or advertises or holds themselves out to the public as being able or willing to perform any of these activities.

There are exclusions for licensed real estate brokers, certain seller financers and their employees, manufactured home retailers and their employees, loan servicers including loan workout

staff when modifying an existing loan, loan underwriters and processors and managers, administrative and clerical staff provided they are not actually engaging in loan originator activity.

It is expected that the CFPB and other bank regulators will interpret this definition broadly and include persons engaging in referral activity within the definition. However, the rule does list examples of the types of activity that will not make a person a loan originator. These include: simply handing out application forms, accepting completed forms, providing general information in response to customer questions, providing loan originator contact information, discussing other credit products and services unrelated to home loans, or providing broad and general guidance on qualifications or criteria without discussing or assessing the consumer's specific situation or circumstances or discussing particular credit terms available from the creditor. Backroom loan processors and personnel involved in underwriting, credit approval and loan pricing are not loan originators provided that all 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. Managers and others who only occasionally engage in originator type activity will still be covered.

Note that the definition of "loan originator" under Reg. Z is a little broader than the definition of "mortgage loan originator" in the SAFE Act and its regulations. Under revised 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, <u>or</u> holds themselves out to the public as being willing to do so. Engaging in any one of those activities 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. That distinction could be important as we discuss the loan originator qualification requirements below. It is also important to note that the coverage of the compensation and qualification rules may possibly extend to persons who technically may not be required to be registered as a mortgage loan originator in the national registry.

<u>Compensation</u>. Dodd-Frank codified the existing prohibition in Reg. Z prohibiting loan originator compensation based on the terms or conditions of the loan transaction. Revised Reg. Z continues that prohibition and clarifies the scope and application of the rule.

The final rule prohibits compensation based on any of the mortgage loan transaction's terms or conditions, including any factor that might serve as a proxy for a loan term or conditions. A "term of a transaction" is defined as any right or obligation of the parties to a credit transaction. Things like the interest rate, maturity, or type of loan would all be terms of the transaction. Other things might be a little more subtle. For example, paying compensation to an originator for referring the borrower to an affiliate of the lender to buy title insurance would be prohibited. The principal amount of the loan is not considered to be a term of the transaction provided that any compensation based on loan amount is based on a fixed percentage.

A proxy for a term of a transaction is any factor that: (i) consistently varies with a transaction term over a significant number of transactions, and (ii) the loan originator has the ability, directly or indirectly, to add, drop, or change. Credit score might be one example as the interest rate or other terms of the loan may vary based on credit score or credit quality. The basic question is whether or not the compensation of the loan originator would be different if any term of the transaction were different.

Loan originator compensation may not be reduced to offset the cost of a change in transaction terms. For example, an originator could not grant a pricing concession by giving up part of his or her commission to pay a portion of the consumer's closing costs. However, the final rule does allow

loan originator compensation to be reduced to cover unexpected increases in estimated settlement costs. For example, a bank's loan originator compensation plan could include a deduction from the originator's compensation to pay the amount needed to cure a RESPA disclosure tolerance violation.

The rule generally prohibits loan originator compensation 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. As a result, compensation based on profitability of a pool of loan transactions or a department or branch that includes mortgage loan profits would be prohibited. However, the final rule includes two important exceptions to this prohibition.

First, contributions to any IRS qualified defined benefit or defined contribution plan are excluded. So, contributions to things like a 401(k), employee annuity plan, simple retirement account, simplified employee pension, or eligible deferred compensation plan, if they fall within certain specified sections of the Internal Revenue Code, would be permissible. The second exception allows payment of bonuses and contributions based on mortgage business profits to other non-deferred bonus and incentive plans if the amount paid to an individual loan originator is not based, directly or indirectly, on the terms of that originator's loan transactions and either of the two following conditions are met: (i) the payment does not exceed 10% of that individual's total compensation, including the bonus payment, for the same period, or (ii) the person was a loan originator for 10 or fewer transactions during the preceding 12 months. Also, the 10% cap only applies to payments based on profits from mortgage-related business, meaning compensation based on profits from other areas could be paid in addition to the 10% cap related to mortgage activity. This could be important in compensation plans for branch, department or other managers. Managers who engage in limited loan origination activity for 10 or fewer transactions may receive bonus payments based on overall bank or branch profitability that includes mortgage-related profits. For managers that engage in more than 10 transactions, the bank may be able to come up with a plan that allocates revenues and expenses between its mortgage-related business activity and its other lines of business so that any bonus payments based on profitability of other types of business would not be subject to the 10% cap.

Dual compensation. Revised Reg. Z continues the existing prohibition against a loan originator who receives compensation directly from a consumer from also receiving compensation from any other person in connection with the same mortgage loan. The final rule clarifies that mortgage brokers who receive compensation from the consumer directly may compensate broker employees and contractors, although the payments cannot be based on the terms of the loans they originate.

Upfront points and fees. One of the things that, thankfully, did not make it into the rule is the Dodd-Frank prohibition against lenders charging any upfront points or fees on a loan transaction where the loan originator receives any compensation from any person other than the consumer. Dodd-Frank allowed the CFPB to waive or create exemptions from this prohibition if that was in the interests of consumers and the public. The CFPB originally proposed to waive the ban and allow creditors to charge upfront points and fees as long as a no points and fees alternative was offered at the same time. Instead, the CFPB included a complete exemption in the final rule and indicated it would study the issue further.

Loan originator qualifications. Revised Reg. Z makes loan originator organizations responsible for making sure that their individual loan originators are properly qualified and licensed or registered to the extent required under State and Federal law. For depository institutions and their subsidiaries whose employees are exempt from state licensing requirements, this means that the bank or company must: (i) ensure that their loan originator employees meet character, fitness, and criminal background standards similar to existing SAFE Act licensing standards; and (ii) provide training to its loan originator employees that is

appropriate and consistent with the employee's origination activities.

To satisfy the character, fitness and background standards, a loan originator organization must obtain three basic things about each individual loan originators: (i) a criminal background check; (ii) information about any administrative, civil or criminal findings concerning that person; and (iii) a credit report. Licensing or registration and inclusion in the national registry will satisfy the requirement for a criminal background check and collection of information about administrative, civil or criminal findings. Credit reports will need to be obtained on individual loan originators hired after January 10, 2014. The commentary makes it clear that it is not necessary to go back and obtain this information on someone hired before that date who satisfied the applicable statutory or regulatory background standards at the time they were hired (i.e., they are licensed or registered originators).

As we noted above, the definition of "loan originator" under revised Reg. Z is broader than the definition of "mortgage loan originator" under the SAFE Act and regulations. Some states use a broader definition in their loan originator licensing laws as well. To the extent you employ a 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 the employer's responsibility 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 better course of action may be to make sure that anyone who falls within the broad definition of "loan originator" under Reg. Z is registered in the national registry.

The CFPB had originally proposed to require registered loan originator employees of banks and their subsidiaries to meet the same pre-licensing and continuing education requirements that apply to State licensed mortgage loan originators. Fortunately, the CFPB only included in the final rule a general requirement that loan originators receive periodic training covering State and Federal law requirements that apply to that person's loan origination activities.

Use of NMLSR identifiers. Revised Reg. Z requires that the name and Nationwide Mortgage Licensing System and Registry (NMLSR) ID number of the loan originator organization and the individual loan originator employee primarily responsible for the particular transaction be shown on the credit application, the note, and the mortgage or deed of trust.

Use of mandatory arbitration. Revised Reg. Z prohibits use of mandatory arbitration clauses and agreements in connection with any dwelling secured consumer credit transaction including any home equity line of credit secured by the consumer's principal dwelling. It does not prohibit post-dispute voluntary agreements to arbitrate. The rule also prohibits the application or interpretation of any 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 for any alleged violation of Federal law.

Single premium credit insurance. Revised Reg. Z 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. It does not prohibit credit insurance or debt cancellation type products that are paid for on a monthly basis.

Policies and procedures. Revised Reg. Z requires all depository institutions to establish and maintain written policies and procedures reasonably designed to ensure and monitor compliance of the institution, its subsidiaries and their employees with the rules on loan originator compensation, prohibited steering, loan originator

qualifications, and use of the NMLSR identifiers. Those 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. Revised Reg. Z extends existing recordkeeping requirements to require creditors and mortgage brokers to retain records reflecting their compliance with the compensation rules for three years. A creditor must maintain records of all compensation it pays to a loan originator, which could include an employee or a loan broker, and any related compensation agreement for at least 3 years after the payment. A loan originator organization, which could include a broker, must maintain records of all compensation it receives from a creditor, a consumer or another person, and all compensation it pays to its individual loan originators and any related compensation agreement, for at least 3 years after the payment.

Implementation. As noted above, 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. While the new rules are in some respects a continuation and clarification of some existing requirements, compliance will require a number of steps. It will be necessary to write new policies and procedures, if they do not already exist, and to review and revise any existing policies and procedures relating to hiring loan originators, their qualifications, background screening, and inclusion in the national registry. Periodic loan originator training should be implemented if it does not already exist, and the requirements for that training should be included in the written policies and procedures. As part of the review process, a bank may want to re-consider whether all employees who may be a loan originator under the revised Reg. Z definition have been identified. Loan applications, note forms, and mortgage or deed of trust forms will need to be revised to add NMLSR identifiers. Those documents and others may need to be revised to remove mandatory arbitration clauses or terms relating to financing credit insurance. Record retention schedules should be reviewed and revised where appropriate. Finally, compensation and bonus plans covering loan originators and managers may need to be reviewed and revised.

(Cliff Harrison)

UPDATE ON FLOOD CHANGES

The Biggert-Waters Flood Insurance Reform Act passed by Congress last year made a number of changes to the National Flood Insurance Program (NFIP). It was not clear from the language of the Act when some provisions were to become effective, and in March, the Fed, FDIC, OCC, NCUA and the Farm Credit Administration issued an interagency guidance on the effective dates. As noted in the guidance, some provisions became effective on passage while others will not become effective until implementing regulations are written. The provisions which became effective with passage on July 6, 2012 are:

Force placement. The following amendments concerning force placement of flood insurance became effective on passage:

- The borrower may be charged premiums or fees incurred for coverage beginning on the date on which flood insurance coverage lapsed or the borrower did not provide sufficient coverage amount, including the 45-day force placement notice period ;

- The lender or servicer must, within 30 days of receipt of confirmation of the borrower's existing flood coverage, terminate any force-placed insurance and refund all force-placed insurance premiums and any related fees for any period of overlap between the borrower's policy and the force-placed policy; and

- The lender or servicer must accept as confirmation of the borrower's existing flood policy a declarations page that includes the flood policy number and the identity and contact information for the insurance company or agent.

Civil money penalties. Effective with passage, the maximum civil money penalty for a flood violation has been increased to $2,000, and the per year penalty cap has been deleted.

The following provisions will not become effective until implementing regulations are issued:

Private flood insurance. Once implementing regulations become final, lenders will be required to accept private flood policies if the coverage satisfies the standards in the Act. In addition, required disclosures to borrowers will include statements that:

- Flood insurance under the NFIP is available from private insurance companies or from the NFIP directly;
- Flood insurance that provides the same level of coverage as an NFIP policy may be available from private insurance companies; and
- Borrowers are encouraged to compare policies.

Escrow of flood premiums. Once implementing regulations become final, lenders and servicers will be required to escrow for flood premiums on all loans secured by residential real estate or a mobile home outstanding or entered into after July 6, 2014, unless exempt. Except where state law requires otherwise, lenders with less than $1 billion in total assets will be exempt unless, as of July 6, 2012, the lender was not otherwise required by federal or state law to escrow taxes or insurance for the term of the loan, and the lender did not, as a matter of policy, require escrow of taxes and insurance.

Flood Q & A. The agencies made a few minor changes to the proposed Q & A and said they expect to undertake a full review of the Interagency Questions and Answers once final regulations are written.

Premium rates. While not mentioned in the interagency guidance, one of the most significant changes brought about by the Act are increases in premium rates to more closely reflect true flood risks. Subsidized rates for properties other than primary residences are being phased out over a period of time. Owners of non-primary or secondary residences located in a flood hazard area will see rate increases of 25% per year beginning January 1, 2013 until rates reflect true risk. Owners of properties that have experienced severe or repeated flooding and owners of business properties will likewise see rate increases of 25% per year beginning October 1, 2013 until rates reflect true risk. Policies covering primary residences will be able to keep their subsidized rates until the property is sold, the policy lapses, a new policy is purchased, or the property suffers severe, repeated flood losses. NFIP is encouraging policy holders experiencing premium increases to talk to their agent about their options, obtain an elevation certificate and make sure their premium rate is correct, and to consider higher deductibles.

Flood guidelines rescinded. Because of the Biggert Waters changes, FEMA has determined that its Mandatory Purchase of Flood Insurance Guidelines publication (the September 2007 blue book) is outdated and has rescinded the publication. No word on how long it might take FEMA to update the publication, but it seems likely it will not be until sometime after final regulations are issued under the Act. In the meantime, though, I would hang on to my copy. It and the interagency Q & A are the best written guidance we have right now.

(Cliff Harrison)

MISSISSIPPI STATE LAW REQUIREMENTS FOR APPRAISALS AND EVALUATIONS

Mississippi's Real Estate Appraiser Licensing and Certification Act (the "Act") prohibits any person from engaging in real estate appraisal activity without a license. Real estate appraisal activity is defined in the act as "the act or process of making an appraisal of real estate or real property and preparing an appraisal report." Real estate

appraisal activity also includes evaluations of property. There is an exception for bank employees acting on behalf of the bank, but that exception does not apply if a fee is charged for the appraisal or evaluation.

The licensing requirement only applies to those who provide significant professional assistance. The Act provides three examples of activities that are not considered to be significant professional assistance. These activities are: (1) assistance with the gathering of data upon which the report will be based (2) taking photographs, preparing charts or graphs, typing or other similar acts of preparing the appraisal report, and (3) other assistance that does not involve analysis or developing opinions or judgments.

Therefore, if your bank charges a fee for an internal appraisal or evaluation, then such activity falls within the scope of the Act. In-house appraisals or evaluations for which a fee is charged must only be prepared by a licensed appraiser.

Clarification on Final Escrow Rules

At the February meeting, we discussed the CFPB's final escrow rules that were issued on January 10, 2013, relating 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.

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

On April 12, 2013, the CFPB issued a proposed rule providing clarification on certain aspects of the final escrow rule, including the exception for creditors operating predominately in rural and underserved areas. This proposal is expected to be the first of additional guidance to follow soon. This guidance was given priority because the final escrow rule becomes effective June 1, 2013, while the remaining, recently finalized rules do not become effective until January 10, 2014. It is important to note that the clarifications related to the rural and underserved exception will apply not only to the final escrow rule, but to the applicable provisions in the ability-to-pay, HOEPA, and appraisal 2013 final rules as well.

First, the CFPB clarified the definition of rural. A rural county is one that is not located in a metropolitan statistical area (MSA) or one that is adjacent to a micropolitan statistical area and 2% of its population commutes to the MSA for work. In the proposed guidance, the CFPB clarified that in order for an area to be adjacent to a MSA, physical contiguity coupled with the commuting standard mentioned previously are required.

The method of determining which counties are rural is also further explained in the proposal. The determination is based on applicable Urban Influence Codes (UICs) developed by the USDA's Economic Research Service.

The determination of whether a county is underserved is based on HMDA data. The rule currently provides that the determination of underserved status is based on HMDA data "for that calendar year." There was some confusion with the final rule due to the fact that HMDA data is not typically available until the third or fourth quarter of any given year. Therefore, the CFPB proposes to clarify that the intent was for the most recent HMDA data, the data for the "preceding calendar year," to be used in making the determination of underserved status.

Finally, as previously mentioned, the final escrow rule takes effect on June 1, 2013, and other recently finalized rules relating to higher priced mortgage loans, including the ability to repay rule and limitations on prepayment penalties, do not take effect until January 10, 2014. In the final rule, the CFPB inadvertently removed consumer protection provisions that are currently in place. In order to prevent a gap in consumer protection provisions for higher-priced mortgage loans, this proposed rule provides for an expansion of the current protections through January 9, 2014, with

the new finalized protections effective beginning on January 10, 2014.

Comments on this proposal are due May 3, 2013.

(Memrie Fortenberry)

UCC ARTICLE 9 CHANGES

The Governor recently approved SB 2609 revising Mississippi UCC articles 2, 4 and 9. The bill adopts the 2010 amendments to the uniform version of Article 9 and makes a number of technical amendments intended to clarify and address ambiguities in existing Article 9 and to override the effects of bad case law which has created problems in some states. Several of the changes, however, will be important to lenders filing UCC financing statements on collateral owned by an individual or a trust or estate. The new law becomes effective July 1, 2013, and will impact how lenders should conduct UCC searches and prepare financing statements and continuation statements on individual debtors and trusts and estates after the effective date.

Under existing UCC Article 9, a financing statement on collateral owned by an individual, as opposed to an entity, is deemed to sufficiently identify the debtor if the financing statement simply provides the individual name of the debtor. As you can imagine, courts in different states have interpreted this provision in different ways. In some states, filings under nicknames, or filings omitting a middle name or suffix have been found to be seriously misleading and ineffective. This has created some uncertainty about the proper name in which to search and to file a financing statement on an individual.

Drafters of the 2010 amendments to the uniform law recognized the need to clarify Article 9 and offered up a couple of alternatives. Most states, including Mississippi, Arkansas, Tennessee and Louisiana, have adopted alternative A, sometimes known as the "only if" alternative, which provides that a financing statement adequately identifies an individual debtor only if the name of the debtor is shown in the exact same way in which it appears on either an unexpired driver's license or an unexpired non-driver's license identification card issued by the state in which the debtor resides. If the individual does not have a driver's license or a state-issued identification card, the financing statement is sufficient only if it provides the individual name of the debtor or the surname and first personal name of the debtor.

This means that after the effective date, in order for the lender to be properly perfected on an individual debtor and be assured of priority, the lender will need to conduct a UCC search and file a financing statement reflecting the name of the debtor in the exact same manner as it appears on the debtor's driver's license or a state-issued non-driver's license identification card. This alternative will provide much greater certainty with respect to UCC filings of individual debtors going forward.

The amendments also create new rules for filing where the debtor is a trust or a personal representative of a deceased individual, such as an executor or administrator of an estate in Mississippi. Under existing UCC Article 9, most entities like corporations, limited liability companies and limited partnerships are considered to be registered organizations (basically, defined as an entity that must file organizational documents with a state or the federal government in order to be created). When the debtor is a registered organization, a financing statement must reflect the name of the debtor exactly as it is shown on the filed organizational documents. For example, the name of a debtor that is a corporation must be shown in the exact same way as the name appears on the articles of incorporation filed with the Secretary of State.

Under the amendments to Article 9, if the debtor is a trust that is also a registered organization, then a financing statement is sufficient if it shows the name of the debtor in the same manner as the name appears on the publicly filed organizational documents for that trust. Some states have laws allowing certain trusts to be formed for commercial or business purposes, such as a Delaware business trust. When a trust of that sort is required by state statute to file its organizational

documents with the state in order to conduct business, it would be a registered organization for purposes of UCC Article 9. Most trusts, however, would not fall in that category.

Most common law and other trusts are created under a written trust agreement or under the will of a deceased individual. There has been confusion under existing Article 9 about filings where the debtor is a trust or estate of an individual. Should the filing be in the name of the trust or trustee? For an estate, should it be in the name of the deceased or the executor or administrator? In an attempt to simplify and clarify the law, the amendments to Article 9 say the lender should look first to the document creating the trust (the organic record of the trust in Article 9 parlance) to determine the name of the debtor for UCC filing purposes. In the case of collateral held in a trust, where the trust agreement or the will creating the trust specifies a name for the trust (for example, "The John Doe Family Trust"), then that name must be used as the name of the debtor in the financing statement. If no name for the trust is provided by the trust agreement or will, then the name of the settlor or grantor of the trust, or the deceased testator in the case of a trust created under a will, must be used.

In addition, the amendments clarify the existing Article 9 requirement that a financing statement covering collateral held in trust include additional information with respect to that collateral to distinguish it from the trustee's own property or property held in other trusts by the same trustee. The amendments emphasize that the additional information should appear in the body of the financing statement but not in the portion of the financing statement designated for the debtor's name. In the case of the named trust, the financing statement must indicate somewhere in the body that the collateral is held in a trust. In the case of an unnamed trust where the name of the grantor or testator will be used, the financing statement must provide additional information in the body of the statement sufficient to distinguish the particular trust involved from trusts having the same grantor or the same testator and indicate that the collateral is held in a trust. The new national UCC financing statement form provided in the 2010 uniform amendments includes a checkbox that can be used for that purpose.

After the effective date, then, where collateral is held in a trust that is not a registered organization and the trust is given a name in the trust organic document (the trust agreement or will), then a UCC filing should be in the name given to the trust in the trust document regardless of whether legal title to the collateral is technically considered to be held by the trust or by the trustee of the trust. Where the trust document does not assign a particular name to the trust, then the name of the grantor of the trust or, in the case of a trust created under a will, the name of the deceased individual - the testator - must be used.

In cases where the collateral is held in the estate of a deceased individual and is being administered by the executor or administrator of the estate of the deceased, a financing statement should use the name of the deceased person as the debtor and, in a separate part of the financing statement, indicate that the collateral is being administered in an estate by the personal representative.

The changes become effective July 1, 2013. The statutes includes transition provisions which make it clear that any existing filings that satisfied the law in effect prior to July 1, 2013 generally remain effective until the earlier of the time they would lapse under existing law or June 30, 2018. This means that an existing filing which identifies the debtor in the manner required by applicable law prior to the new amendments continues to be effective, and there is no need for a lender to have to search its existing records and change existing filings. However, when those existing filings come up for continuation, if the existing filing does not comply with the new law, it will need to be amended at that time. In that event the lender will need to file an amendment along with the continuation statement to revise the debtor's name or any other portions of the financing statement that do not comply with the new requirements. If an existing financing statement is properly amended during the transition period, then perfection and priority should relate back to the time of the original filing. For new filings after the effective date, it will be important to conduct

any UCC searches and prepare any new filings following the new law.

(Cliff Harrison)

MRCG QUARTERLY MEETING TO BE HELD IN JACKSON, MS ON MAY 23, 2013

The MRCG will hold its May Quarterly Meeting on May 23, 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 May meeting, we will discuss the question of originating Qualified Mortgages vs. simply complying with the Ability to Repay rule and the policies and procedures needed for both. Recent additional Guidance for small lenders issued by the CFPB will be covered, as will be each of the five (5) additional CFPB rules regarding servicing requirements, MLO compensation, new escrow and appraisal requirements, etc..

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, May 17, 2013 so that arrangements for lunch can be finalized. We look forward to seeing you there.

(Ed Wilmesherr)

MSRCG MEETING TO BE HELD IN MEMPHIS, TN ON MAY 21, 2013

The MSRCG will hold its May Quarterly Meeting on May 21, 2013, at The Racquet Club of Memphis in the Large Ballroom located at 5111 Sanderlin Avenue, Memphis, Tennessee. Registration will begin at 9:00 a.m. with the meeting to begin at 9:30 a.m.

During the May meeting, we will discuss the question of originating Qualified Mortgages vs. simply complying with the Ability to Repay rule and the policies and procedures needed for both. Recent additional Guidance for small lenders issued by the CFPB will be covered, as will be each of the five (5) additional CFPB rules regarding servicing requirements, MLO compensation, new escrow and appraisal requirements, etc..

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 Thursday, May 16, 2013 so that arrangements for lunch can be finalized. We look forward to seeing you there.

(Ed Wilmesherr)

MRCG-MSRCG COMPLIANCE CALENDAR

07/06/12 – Increased CMPs for flood violations effective	06/01/13 – Mandatory arbitration and financing credit life on mortgage loans prohibited
02/12/13 – MSRCG Quarterly Meeting	07/01/13 – UCC Article 9 changes for individual debtors, trusts and estates effective
02/21/13 – MRCG Quarterly Meeting	07/18/13 - MRCG-MSRCG Joint Steering Committee Meeting
03/26/13 – Reg. E requirement for posting fee notice on ATMs repealed.	08/15/13 - MRCG Quarterly Meeting
03/28/13 Reg. Z amendment limiting first year fees on credit card account effective	08/27/13 - MSRCG Quarterly Meeting
04/18/13 – MRCG-MSRCG Joint Steering Committee Meeting	09/19/13 – MRCG-MRSCG Joint Steering Committee Meeting
05/03/13 – Comment period on proposed amendment to 2013 escrow rule expires	11/19/13 - MSRCG Annual Meeting
05/17/13 – Comment period on proposed CRA Q&A expires	11/21/13 - MRCG Quarterly Meeting
05/21/13 - MSRCG Quarterly Meeting	01/10/14 – Ability to repay, qualified mortgage, mortgage servicing, MLO compensation and qualifications, HOEPA high cost mortgage rules effective
05/23/13 - MRCG Quarterly Meeting	01/18/14 – HPML appraisal rule, Reg. B rule on delivery of copy of appraisal effective
06/01/13 – Escrow accounts for higher-priced mortgages expands to 5 years	07/06/14 – Escrows for flood insurance premiums required for $1B + institutions

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