High Cost Mortgages and Homeownership Counseling - CFPB Proposed Rule

Executive Summary

The Bureau of Consumer Financial Protection ("CFPB" or "Bureau") recently released a proposed rule to amend Regulation Z, which implements the *Truth-in-Lending Act* ("TILA"), to address provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act") that:

- Expand the types of mortgage loans subject to the *Home Ownership and Equity Protection Act* ("HOEPA") by including purchase money mortgage loans and home equity lines of credit;
- Revise the high cost mortgage triggers used to identify mortgage loans covered by HOEPA by lowering the relevant annual percentage rates ("APRs") and points and fees thresholds, and adding a trigger for certain prepayment penalties; and
- Impose certain other requirements on mortgage loans covered by HOEPA, including a pre-counseling requirement.

The proposed rule would also amend Regulation Z and Regulation X, which implements the *Real Estate Settlement Procedures Act* ("RESPA"), to impose other requirements related to homeownership counseling including:

- A requirement for lenders to distribute a list of homeownership counselors or counseling organizations to consumers within a few days after applying for any mortgage loan; and
- A requirement that first-time borrowers receive homeownership counseling before taking out a negatively amortizing loan.

Comments are requested no later than September 7, 2012. The Bureau expects to issue a final implementing rule by January 21, 2013 though it is specifically requesting comment on an effective date.

Background

The *Home Ownership and Equity Protection Act* was enacted in 1994 as an amendment to TILA to provide additional protections to consumers of certain mortgage loans with high costs. At that time, the statute applied to closed end mortgage credit generally, but excluded purchase money mortgages and reverse mortgages. Loans that met HOEPA's established high interest rate or high fee trigger thresholds were determined to be "high-cost mortgages" and were subject to special disclosure requirements and restrictions on loan terms.

The Dodd-Frank Act expanded the coverage of HOEPA to include purchase money mortgage loans and open-end credit such as home equity lines of credit. Reverse mortgages remain excluded. The Dodd-Frank Act also modified the HOEPA high interest rate and high fee trigger thresholds and requirements. As part of TILA, HOEPA provisions are implemented through Regulation Z.

The CFPB states that data collected through the *Home Mortgage Disclosure Act* ("HMDA") indicate less than one percent of loans made annually exceed the current HOEPA triggers and this share has generally declined over time. Between 2004 and 2010, HOEPA loans comprised approximately 0.2 percent of the originations of home-secured refinance or home-improvement loans made by creditors with only 0.06 percent of those loans being covered by HOEPA in 2010. The CFPB estimates the number of HMDA-reported refinance and home-improvement loans covered by HOEPA in 2010 would have increased from 0.06 percent to 0.3 percent of covered loans had the proposed APR and points and fees triggers been in effect at that time.

Description

High-Cost Mortgages

The CFPB's proposed rule would implement changes to the HOEPA regulations governing high cost mortgages imposed by the Dodd-Frank Act.

In particular, the proposed rule would amend Regulation Z to expand the scope of loans to be considered for HOEPA protections to include most types of mortgages secured by a consumer's principal dwelling including purchase money mortgage loans, refinances, closed-end home-equity loans, and open-end credit plans such as home equity lines of credit. Reverse mortgage loans would continue to be excluded.

The proposed rule would also amend Regulation Z to implement the Dodd-Frank Act modifications to the interest rate and fee thresholds that trigger application of the HOEPA protections for the scope of covered loans. Under the proposal, a "high-cost mortgage" would mean any consumer credit transaction, other than a reverse mortgage transaction, that is secured by a consumer's principal dwelling and in which any one of the prescribed thresholds is met:

- The loan's APR exceeds the average prime offer rate ("APOR") of a comparable transaction by:
  - 6.5 percentage points for most first-lien mortgages, or
  - 8.5 percentage points for a first lien transaction if the dwelling is personal property and the total loan amount is less than $50,000, or
  - 8.5 percentage points for a subordinate lien mortgage.
- The loan's points and fees (other than bona fide charges not retained by the mortgage originator, creditor or an affiliate) exceed 5 percent of the total transaction amount, or the lesser of 8 percent or $1,000 for loans below $20,000.
- The creditor may charge a prepayment penalty more than 36 months after loan consummation or account opening, or penalties that exceed more than 2 percent of the amount prepaid.

The proposed rule includes two alternatives to implement the APR threshold used to determine HOEPA coverage for closed end mortgage loans.

- Alternative 1would use the APR as the rate to be compared to the APOR.

- Alternative 2 would substitute the APR with a "transaction coverage rate" that would be compared to the APOR.
  - The CFPB states Alternative 2 would only be adopted if the proposed changes to the definition of "finance charge" under the CFPB's integrated disclosures rule (please refer to Regulatory Practice Letter 12-14) are also adopted. This proposal would expand the definition of finance charge to generally include all charges and fees paid directly or indirectly by the consumer and imposed directly or indirectly by the creditor, plus certain other creditor charges and third party charges, effectively increasing related APR calculations. The transaction coverage rate would exclude certain charges paid to third parties included under the proposed new definition.
- The APR threshold used to determine HOEPA coverage for open-end mortgage credit would use the APR as the rate to be compared to the APOR.

As proposed, the interest rate used to determine HOEPA coverage for variable-rate loans or plans would generally be based on the maximum margin permitted at any time during the loan or plan, added to the index rate in effect at consummation or account opening. The APOR for open-end credit plans would be determined based on the APOR for the most closely comparable closed-end mortgage loan. The definition of points and fees "would conform closely to what has previously been proposed to implement requirements of the Dodd-Frank Act concerning assessment of consumers' ability to repay mortgage loans, such as by including loan originator compensation for closed-end mortgage loans."

The proposed rule also would implement new Dodd-Frank Act restrictions and requirements concerning loan terms and origination practices associated with high-cost mortgages. For example, as proposed:

- Balloon payments would largely be banned (except for certain open-end credit plans) and creditors would be prohibited from charging prepayment penalties and financing points and fees.
- Late fees would be restricted to 4 percent of the payment that is past due, fees for providing payoff statements would be restricted, and fees for loan modification or loan deferral would be banned.
- Creditors originating open-end credit plans would be required to assess consumers' ability to repay the loans.
- Creditors and mortgage brokers would be prohibited from recommending or encouraging a consumer to default on a loan or debt to be refinanced by a high-cost mortgage.
- Creditors would be required to obtain confirmation from a Federally-certified or approved homeownership counselor that the consumer has received counseling on the advisability of the loan, before making a high cost mortgage.

All Mortgages

In addition to the proposed changes that would impact high-cost mortgages covered by HOEPA, the Bureau's proposal would require additional changes that would impact all mortgage loans, including:

- Amendments to Regulation X that would implement provisions that lenders, mortgage brokers or dealers provide a list of five Federally-certified or approved homeownership counselors or organizations to consumers within three business days of applying for any mortgage loan.

- The list would be required to include homeownership counselors or organizations located in the consumer 's zip code or the closest zip codes to the applicant's address if five in the immediate zip code are not available.
- The list would be required to only include homeownership counselors made available to lenders by the Bureau or approved by the Department of Housing and Urban Development.
- A mortgage broker or dealer would be permitted to provide the list to the consumer but the lender would be required to ensure that such a list complied with the rule.

Note: the definition of an application would follow the Bureau's proposed definition in the integrated mortgage disclosures rule, which would exclude the current "other information" language.

- Amendments to Regulation Z to implement a requirement under TILA that creditors obtain confirmation that a first-time borrower has received homeownership counseling from a Federally-certified or approved homeownership counselor or counseling organization before making a negative amortization loan to the borrower. (A negative amortization loan has a payment schedule that can cause the loan's principal balance to increase over time.)

Commentary

Although the number of HOEPA loans originated by creditors has been relatively small, the combined effect of expanding the scope of covered loans, decreasing the interest rate trigger thresholds and adding new triggers will likely increase substantially the number of loans subject to HOEPA protections. All creditors, including those that do not engage in HOEPA lending, will need to reassess and update their policies and procedures, systems requirements and training programs to incorporate the new requirements and definitions once they are finalized. The CFPB has coordinated the comment period for this proposal with the provisions to redefine the "finance charge" proposed in its rule to integrate TILA and RESPA mortgage disclosures. The proposed definition, however, is not part of the Dodd-Frank Act mortgage-related amendments. Bank and nonbank creditors may want to consider providing comment on the potential impact this proposed new definition might have on the application of the HOEPA triggers, the feasibility of using the transaction coverage rate, and the impact on mortgage lending generally. Commenters might also address the impact the HOEPA amendments will have on their operating systems, controls and reporting requirements individually and in combination with the other mortgage-related proposals under consideration by the CFPB.

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