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1. CFPB Issues Final Rule Requiring Verification of a Borrower’s Ability to Repay

The Consumer Financial Protection Bureau (the “CFPB”) has released a final rule amending Regulation Z to implement minimum underwriting standards that require mortgage lenders, including banks, to obtain and verify certain information to determine whether a consumer can afford to repay the home mortgage loan for which the consumer has applied. The final rule published on January 10, known as the Ability-to-Repay rule, implements sections 1411 and 1412 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which requires lenders to make a reasonable, good faith determination of a consumer’s ability to repay any home mortgage loan (other than home equity loans, timeshare plans, reverse mortgages, or bridge loans) and establishes certain protections from liability for a loan that meets the statutory criteria to be considered a “qualified mortgage.” The Ability-to-Repay rule requires a lender to consider eight underwriting standards when determining a consumer’s ability to repay a home mortgage loan. A lender will be presumed to have complied with the Ability-to-Repay rule if the loan meets the criteria to be a qualified mortgage. The statutory criteria for qualified mortgages generally prohibit or limit certain features that are considered risky or potentially harmful to consumers. The Ability-to-Repay rule also permits a lender to refinance a borrower from certain home mortgage loans—such as an adjustable-rate mortgage, an interest-only loan, or a negative-amortization loan—to a more standard loan without undertaking the full underwriting process required by the new rule. The Ability-to-Repay rule will become effective on January 10, 2014.
Nutter Notes: A home mortgage loan may be considered a qualified mortgage under the Ability-to-Repay rule if it does not include negative amortization, interest-only payments, balloon payments, or a term exceeding 30 years. A so-called “no-doc” loan where the lender does not verify income or assets cannot be a qualified mortgage. A loan generally cannot be a qualified mortgage if the points and fees paid by the consumer would exceed 3 percent of the total loan amount, although certain “bona fide discount points” are excluded for prime loans. The final rule provides guidance on the calculation of points and fees and thresholds for smaller loans. The final rule also establishes underwriting criteria for qualified mortgages. For example, the rule requires that monthly payments be calculated based on the highest payment that will apply in the first five years of the loan and that the consumer have a total debt-to-income ratio that is less than or equal to 43 percent. The appendix to the final rule details the calculation of debt-to-income for these purposes and is based on Federal Housing Administration guidelines. In response to concerns that the Ability-to-Repay rule may chill the market for responsibly underwritten loans that do not meet the criteria for qualified mortgages, the final rule provides a second, temporary category of qualified mortgages that have more flexible underwriting requirements as long as they satisfy the general product feature prerequisites for a qualified mortgage and also satisfy the underwriting requirements of, and are therefore eligible to be purchased, guaranteed or insured by, Fannie Mae and Freddie Mac while they operate under federal conservatorship or receivership, or the U.S. Department of Housing and Urban Development, Department of Veterans Affairs, Department of Agriculture or Rural Housing Service.

2. CFPB Rule Clarifies Dodd-Frank Act Loan Originator Compensation Requirements

The CFPB has released a final rule amending Regulation Z to implement provisions of the Dodd-Frank Act restricting loan originator compensation and establishing qualifications, and registration and licensing requirements, for loan originators. The final rule published on January 18 revises or provides additional commentary on Regulation Z’s existing restrictions on loan originator compensation, including application of these restrictions to prohibitions on dual compensation and compensation based on a term of a transaction, and on recordkeeping requirements. The Dodd-Frank Act and Regulation Z prohibit compensation to a loan originator based on any of the transaction’s terms or conditions. The final rule defines “a term of a transaction” as “any right or obligation of the parties to a credit transaction.” The final rule also establishes tests for when loan originators can be compensated through certain profit-based compensation arrangements. The Dodd-Frank Act and Regulation Z prohibit compensation to a loan originator based on any of the transaction’s terms or conditions. The final rule defines “a term of a transaction” as “any right or obligation of the parties to a credit transaction.” The final rule also establishes tests for when loan originators can be compensated through certain profit-based compensation arrangements. The Dodd-Frank Act and Regulation Z provide that where a loan originator receives compensation directly from a consumer in connection with a mortgage loan, no loan originator may receive compensation from another person in connection with the same transaction. The final rule provides an exception to allow mortgage brokers to pay their employees or contractors commissions, although the commissions cannot be based on the terms of the loans that they originate. The final rule becomes effective on January 10, 2014, except for provisions banning mandatory arbitration clauses and financing single-premium credit insurance, which become effective on June 1, 2013.

Nutter Notes: In order to prevent evasion of the prohibitions on compensation based on loan terms, the final rule prohibits compensation based on a factor that is a “proxy” for a term of a transaction. The definition of a proxy focuses on whether the factor consistently varies with a transaction term over a significant number of transactions and whether the loan originator has the ability, directly or indirectly, to add, drop, or change the factor in originating
the transaction. The final rule also prohibits loan originator compensation from being reduced to offset the cost of a change in transaction terms (sometimes called a “pricing concession”). An exception to this restriction allows loan originators to reduce their compensation to defray certain unexpected increases in estimated settlement costs. In order to prevent incentives to up-charge consumers, the final rule prohibits loan originator compensation based on the profitability of a transaction or a pool of transactions. The final rule provides guidance on the application of this prohibition to various kinds of retirement and profit-sharing plans. For example, mortgage-related business profits can be used to make contributions to certain tax-advantaged retirement plans, such as a 401(k) plan, and to make bonuses and contributions to other plans that do not exceed 10% of the individual loan originator’s total compensation. The final rule also provides an exemption to Section 1403 of the Dodd-Frank Act, which otherwise prohibits the payment of upfront points or fees, as long as the loan originator does not receive any compensation directly from the consumer.

3. CFPB Exempts Most Community Banks from Certain Mortgage Servicing Rules

The CFPB has released final rules amending Regulation Z and Regulation X to implement provisions of the Dodd-Frank Act governing mortgage servicing disclosures and protecting consumers from detrimental actions by mortgage servicers. The final rules published on January 17 include exemptions and adjustments for so-called small servicers, defined to mean an institution that services 5,000 or fewer mortgage loans and services only mortgage loans that the institution or an affiliate originated or owns. The small servicer definition is meant to apply to substantially all community banks involved in servicing mortgages. The final rules cover a number of mortgage servicing issues, including periodic billing statements, interest-rate adjustment notices for adjustable-rate mortgage loans ("ARMs"), prompt payment crediting and payoff statements, and force-placed insurance. The final rules require lenders, assignees and servicers, other than small servicers, to provide a periodic statement for each billing cycle containing, among other things, information on payments currently due and previously made, fees, transaction activity, application of past payments, contact information for the servicer and housing counselors, and, where applicable, information regarding delinquencies. The final rules also require, for ARMs, that lenders, assignees and servicers notify consumers between 210 and 240 days prior to the first payment due after the rate first adjusts, and between 60 and 120 days before payment at a new level is due when a rate adjustment causes the payment to change. The final rules will become effective on January 10, 2014.

Nutter Notes: The final rules require servicers to promptly credit periodic payments from borrowers as of the day of receipt. If a servicer receives a payment that is less than the amount due for a periodic payment, the payment may be held in a suspense account until the amount in the suspense account covers a periodic payment. The final rules prohibit servicers from charging a borrower for force-placed insurance coverage unless the servicer has a reasonable basis to believe the borrower has failed to maintain hazard insurance, as required by the loan agreement, and the servicer has provided required notices. An initial notice must be sent to the borrower at least 45 days before charging the borrower for force-placed insurance, and a second reminder notice must be sent no earlier than 30 days after the first notice. The final rules prohibit force-placed insurance where the borrower has an escrow account for the payment of hazard insurance premiums if the servicer can continue the borrower’s homeowner insurance, even if the servicer needs to advance funds to the borrower’s escrow account to do so. There is an exemption from this requirement for small servicers, provided that any force-placed insurance purchased by a small servicer is less
expensive to the borrower than the amount of any disbursement the servicer would have had to make to maintain hazard insurance coverage. The final rules also include mandatory loss mitigation procedures for a mortgage loan secured by a borrower’s principal residence, which restrict a servicer from initiating the foreclosure process while pursuing loss mitigation options. Small servicers are generally exempt from the loss mitigation requirements, provided that a small servicer may not make the first notice or filing required for foreclosure unless a borrower is more than 120 days delinquent, and a small servicer may not proceed to foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing pursuant to the terms of a loss mitigation agreement.

4. Division of Banks Issues Guidance on Troubled Debt Restructuring Determinations

The Massachusetts Division of Banks has issued guidance on the treatment of certain loan modifications for home mortgage loans where the borrowers are not delinquent but whose current loan balance exceeds the value of the property securing the loan. According to the guidance, entitled Guidance Relative to Residential Mortgage Loan Modifications for Non-Delinquent Borrowers and Troubled Debt Restructuring (TDR), released on December 27, 2012, the Division determined that, in certain circumstances, a lender may choose to restructure or modify a home mortgage loan under the revision in mortgage terms statute (Chapter 183, Section 63A of the General Laws of Massachusetts) and that loan may not necessarily have to be treated as a TDR. Specifically, the guidance clarifies that, in cases where both the borrower and current lender wish to modify the terms of a mortgage loan that is not delinquent, the fact that the collateral value has fallen below the outstanding loan amount does not require the credit to be classified as a TDR provided that the borrower is performing satisfactorily under the mortgage loan and is not experiencing financial difficulties. The guidance recommends that a lender consider all facts and circumstances in determining whether a borrower is experiencing financial difficulty and whether the lender is granting a concession. Lenders should have policies and procedures in place to address and document all modification requests in a consistent manner, and perform and document the analysis in making the classification determination in each case, according to the Division.

Nutter Notes: The Division’s guidance addresses TDR classification under Accounting Standards Codification (ASC) Subtopic 310-40: Receivables – Troubled Debt Restructurings by Creditors. ASC Subtopic 310-40 was updated by the Financial Accounting Standards Board (FASB) in April 2011 with Accounting Standards Update ASU 2011-02: A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring. FASB ASU No. 2011-02 is effective for public companies for the first interim or annual period beginning on or after June 15, 2011. The amendments are effective for nonpublic companies for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The accounting guidelines define a TDR as a loan modification in which the creditor grants a concession that it would not otherwise consider for economic or legal reasons related to the debtor’s financial difficulties. The accounting guidelines require two conditions to be present to classify a loan modification as a TDR: the debtor is experiencing financial difficulties and the creditor grants a concession relative to the loan terms as a result of those financial difficulties. The Division’s guidance points out that existing accounting guidance provides possible indicators of when those conditions exist, though all facts and circumstances must be considered when making a TDR determination.
5. Massachusetts Attorney General Clarifies Recent Debt Collection Rules

The Massachusetts Attorney General has issued guidance on the revised debt collection rules that became effective on March 2, 2012. The Attorney General’s guidance released on January 24, 2013 clarifies certain rights and obligations that creditors have when collecting debts from persons within Massachusetts. Among other things, the revised debt collection rules impose an automatic stay on debt collection activities if the borrower provides notice that the debt, or any portion of it, is in dispute. The stay remains in place until the creditor produces the documents necessary to validate the debt, under the revised rules. The guidance clarifies that the automatic stay is not intended to limit the ability of home mortgage lenders to contact delinquent borrowers about loss mitigation programs that may benefit the borrower. Such communications with a borrower are for loan servicing purposes in an effort to assist the consumer, not debt collection purposes. According to the guidance, the Attorney General expects creditors to act in good faith and exercise due diligence to produce documentation sufficient to validate the debt. If a creditor has certain documentation in its possession, which serves to verify the identity of the borrower and the amount of the debt owed to the creditor, then those must be included in the materials provided to the borrower.

**Nutter Notes:** The recent amendments to the debt collection rules expanded the scope of the rules to cover debt collection activities involving cell phone and text messaging and to make first mortgage loans and consumer loans in excess of $25,000 subject to the rules. According to the revised rules, creditors may not initiate a communication with a borrower by telephone more than two times in a seven day period to the borrower’s home, cell, or personal telephone number. The guidance explains that one of the goals of this provision is to limit the fees that a creditor can impose on a borrower through calls, voicemails and text messages. According to the guidance, unsuccessful attempts to reach a borrower by telephone do not count toward the limitation on initiation of communication under this rule if the creditor is, in fact, unable to reach the borrower or to leave a message for the borrower. However, the guidance warns that the Attorney General may still consider enforcement action against any conduct, including initiation of communication by telephone, the natural consequence of which is to harass, oppress, or abuse a borrower.

6. Other Developments: LTOB Limits, Loan Mod Notices, Social Media and Outsourced IA

- **OCC Extends Lending Limit Compliance Deadline for Derivatives**

The OCC announced on January 4 that it has extended from January 1, 2013 to July 1, 2013 the temporary exception for the application of federal lending limits to certain credit exposures arising from derivative transactions and securities financing transactions. The OCC noted that it has the ability to address credit exposures that present undue concentrations on a case-by-case basis through its existing safety and soundness authorities, notwithstanding the extension.

**Nutter Notes:** Section 610 of the Dodd–Frank Act added certain credit exposures arising from derivatives and securities financing transactions to the statutory definition of loans and extensions of credit for purposes of federal lending limits. The OCC’s interim final rule implementing the statutory change for national banks and federal and state savings associations gave institutions until January 1, 2013 to comply.
Division of Banks Releases Form for Loan Modification Reporting

The Division of Banks has issued a Semi-Annual Loan Modification Report worksheet that Massachusetts banks must use to report the final outcome of each loan modification for all loans covered under Chapter 244, Section 35B of the General Laws of Massachusetts, recently added by Chapter 194 of the Acts of 2012. The first report should be filed by February 8, 2013, according to the Division.

**Nutter Notes:** Under the new law, banks must report the final outcome of each loan modification on all loans for which a notice of the right to request a modified mortgage loan was sent under Section 35B. Reports must be submitted semi-annually to the Division of Banks, beginning with the period ending on December 31, 2012.

FFIEC Proposed Risk Management Guidance on the Use of Social Media

The FFIEC released proposed guidance on January 22 on the applicability of consumer protection and compliance laws, regulations, and policies to activities conducted using social media by banks, savings associations, and credit unions, as well as nonbank entities supervised by the CFPB and state regulators. Comments on the proposed guidance are due by March 25.

**Nutter Notes:** The proposed guidance recommends that each financial institution should develop and implement a risk management program that allows it to identify, measure, monitor, and control the risks related to social media. Those risks include risk of harm to consumers, compliance and legal risks, operational risks, and reputation risks, according to the proposed guidance.

Federal Reserve Issues Supplemental Guidance on Internal Audits

The Federal Reserve issued a policy statement on January 23 recommending that banking organizations adopt professional audit standards and other authoritative guidance, including those issued by the Institute of Internal Auditors. The policy statement, Supplemental Policy Statement on the Internal Audit Function and Its Outsourcing, released with Supervision and Regulation Letter No. SR 13-1, does not apply to banking organizations with total consolidated assets of $10 billion or less.

**Nutter Notes:** The policy statement supplements the Federal Reserve’s 2003 guidance, Amended Interagency Guidance on the Internal Audit Function and Its Outsourcing, released with Supervision and Regulation Letter No. SR 03-5. The policy statement explains changes over the past several years in banking regulations related to auditor independence.

Nutter Bank Report

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responsive and detail-oriented.” Visit the U.S. rankings at ChambersandPartners.com. The Nutter Bank Report is edited by Matthew D. Hanaghan. Assistance in the preparation of this issue was provided by Melissa Maichle. The information in this publication is not legal advice. For further information, contact:

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