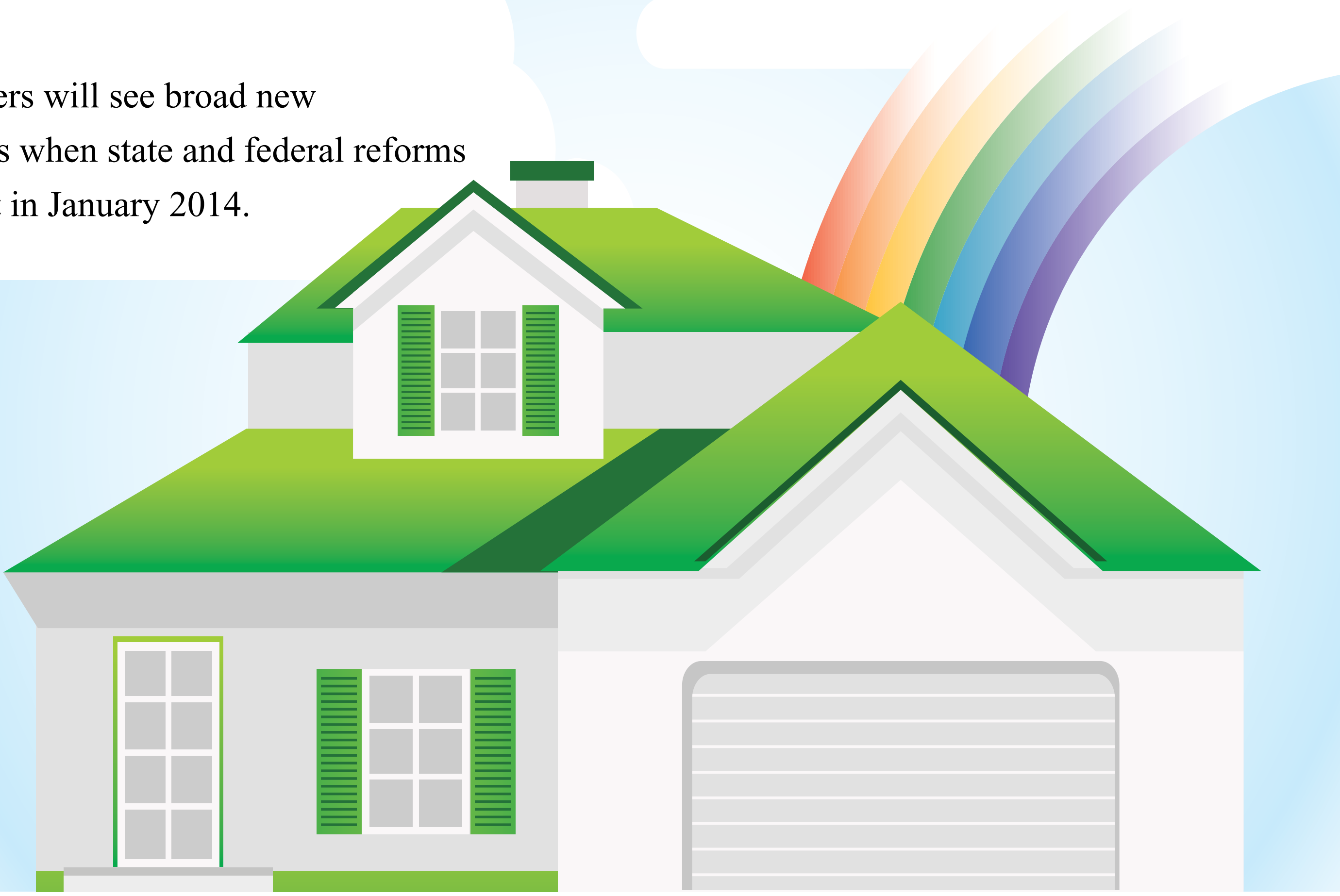
Mortgage Rules Remodeled

Homebuyers will see broad new protections when state and federal reforms take effect in January 2014.



BY HEATHER MORTON

Millions of Americans lost their homes to foreclosure during the recession, and more continue to be at risk. Many simply could not make their monthly payments. Either they weren't qualified for the loan to begin with, circumstances changed, or they weren't prepared when the rate increased.

The federal government responded with The Dodd-Frank Wall Street Reform and Consumer Protection Act—the largest and most complex reform of the financial services industry since the Great Depression. Enacted in 2010, it established the Consumer Financial Protection Bureau to better regulate the products of all kinds of financial institutions, including mortgage lenders, loan originators and mortgage servicers.

Senator Wayne Harper (R) Utah

The bureau, in January, issued new oversight rules to ensure prospective homebuyers have the ability to repay their mortgages and to make the whole process more transparent. They go into effect in January 2014.

"It is important to ensure that the lending situation that occurred in the last decade is addressed and proper lending policies and practices supported. While not perfect, some of the rules

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from the CFPB are good and support this goal," says Utah Senator Wayne Harper (R).

Concerns Expressed

The Consumer Financial Protection Bureau has not been without controversy. "The Consumer Financial Protection Bureau has already greatly increased compliance costs for Texas community banks. Smaller banks have seen their compliance and employee costs increase by tens of thousands of dollars on an annual basis as some of the regulations come out," says Texas Representative Dan Flynn (R).

Representative Dan Flynn (R) Texas

"Further, these new costs will drive down profitability and lead to the consolidation of the banking industry. Fewer banks mean less credit and fewer choices for borrowers across the state."

Critics also object to the bureau having a single director rather than a board of commissioners and contend there is inadequate oversight of the agency's funding.

But others, including the bureau's Director Richard Cordray, argue America's mortgage borrowers bore the brunt of the recession and deserve a robust set of laws to protect them.

Consumer groups generally support the CFPB rulemaking. According to the Center for Responsible Lending, the new rules "generally strike a balanced, reasonable approach to mortgage lending." The center supports the new guidelines as "appropriately broad enough to include the vast majority of creditworthy home owners, and it is clear enough for lenders and borrowers alike to understand."

"These rules set new, national standards to help make sure borrowers are treated fairly and have a better chance of getting a loan modification," says Norma Garcia, senior attorney and manager of the financial services program of Consumers Union, the policy and advocacy arm of Consumer Reports.

The New Federal Rules

Staring next January, mortgage lenders must:

- Verify a borrower's employment, income, assets, debt and credit history.
- Document what the monthly payments on the mortgage are and any other mortgages that exist on the property.
- Evaluate the borrower's ability to repay the loan by looking at his monthly debt-to-income ratio.
- Evaluate the homebuyer's ability to repay based on the entire mortgage, not just the introductory teaser rate.

Lenders will face financial penalties if they fail to exercise good faith in assessing home buyers' ability to repay. And, they can no longer offer so-called "no-doc" or "low-doc" loans to homebuyers, which require little or no documentation.

To demonstrate their compliance with the ability-to-repay requirements, mortgage lenders (with a few exceptions) can choose to issue "qualified mortgages" that prohibit particular features that could harm consumers. Qualified mortgages protect lenders from potential liability.

Transparency Promoted

New rules for loan originators—the people hired by lenders to take residential mortgage applications and negotiate their

States Respond to Foreclosures

Lawmakers have been working to keep people in their homes whenever possible, trying to balance the needs of homeowners with the mortgage industry. "While I certainly support the objectives of the CFPB," says Minnesota Representative Joe Atkins (D), "their efforts will only yield the best results for consumers if they are made in concert with the good work that many states are already doing."

"A number of states, including Utah, recognized the lending challenges and problems in the foreclosure process," says Utah Senator Wayne Harper (R). "It is important for states to exercise leadership in this area and to establish laws and rules that are honed to their individual states' needs and fit into the larger national financial and mortgage framework."

Recognizing there is seldom a "one-size-fits-all" solution to complex policy issues, state lawmakers have introduced hundreds of bills each session on mortgages and consumer protection. Recently enacted legislation falls into four categories: foreclosure consulting services, mediation programs, maintenance of foreclosed property, and notice of foreclosure procedures.

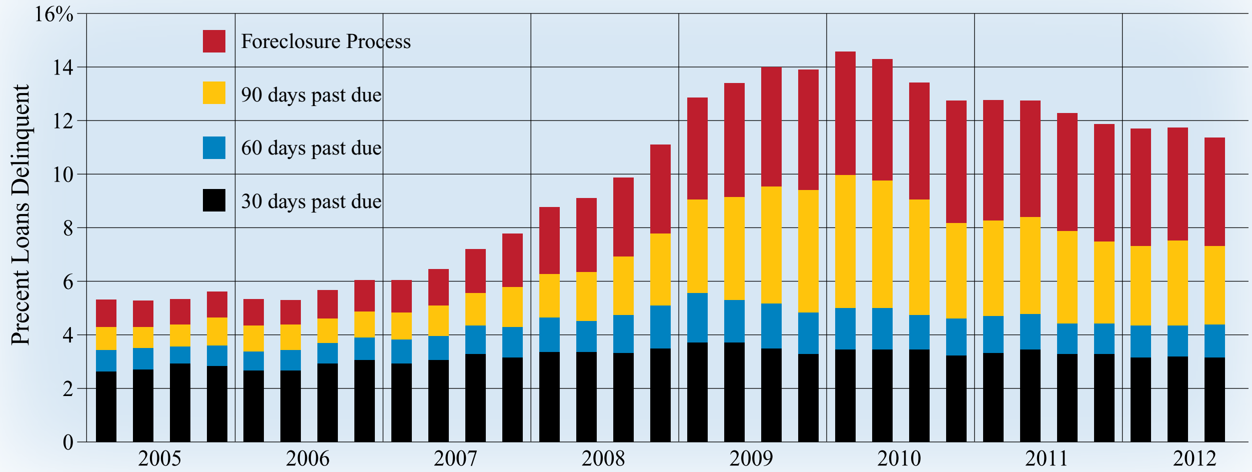
Foreclosure consultants: Thirty states and the District of Columbia regulate standards for foreclosure consultants to prevent scam artists from taking advantage of desperate homeowners. Contracts must be in writing and give the homeowner the right to terminate the agreement.

Mediation programs: As the recession dragged on, payment-assistance programs couldn't meet the demands, so several states created programs to bring lenders and homeowners together to renegotiate the mortgage terms. Starting with Connecticut in 2008, nearly 20 states have created foreclosure mediation or alternative loan-modification programs through legislation. Other states have mediation programs initiated by their state judiciaries.

Property maintenance: To reduce neighborhood blight and maintain property values for nearby homes, 17 state legislatures have enacted laws on maintaining empty properties. For example, California, Connecticut, Georgia, Maryland and Massachusetts maintain registries of foreclosed properties to track the property owners responsible for maintaining the vacant properties.

Notice and foreclosure procedures: Lawmakers in several states have passed laws to: protect tenants renting homes in foreclosure, determine a homeowner's liability in a deficiency judgment when the foreclosure sale price is lower than the loan amount, and require more documentation from lenders, among other measures.

Mortgage Delinquencies and Foreclosures, All Loans



Source: Mortgage Bankers Association of America's National Delinquency Survey.

terms—are aimed at financial incentives. For example, a broker or loan originator can no longer receive additional compensation for steering homebuyers into more expensive loans or for sending them to affiliates for title insurance.

The new mortgage-servicer rules are aimed at making the whole process more transparent for homebuyers, who don't usually select the mortgage servicers. They are selected by the owners of the mortgage note, and they handle payment collections, escrow accounts, loan modifications and foreclosures.

New regulations, among other things, will require these servicers to:

- Provide billing statements that contain a clear breakdown of the payments by principal, interest, fees and escrow and if applicable, information about how to bring delinquent loans current.
- Notify homebuyers of rate changes in adjustable-rate mortgages before the first payment is due.
- Notify homebuyers about alternatives to foreclosure after they are late with two consecutive mortgage payments.

The new rules restrict mortgage servicers from starting foreclosure proceedings if a homeowner has submitted an application to modify the loan, or before a mortgage is more than 120 days delinquent. This additional time gives homeowners an opportunity to look at alternatives to foreclosure. Small servicers—community banks, credit unions—are exempted from several of these provisions.

State Laws Largely Protected

Although the new rules fill hundreds of pages, they generally allow states to enact additional protections for mortgage borrowers, if they choose to do so.

"Both consumers and industry will win when the new rules are understood, applied, and carried out evenly and effectively," says Cordray. Mortgage borrowers, who have dealt with much heartache since the financial crisis, deserve this level of attentiveness."

The mortgage industry's response to the announcement of the new rules has been mixed. The American Bankers Association recognizes the need to reform certain mortgage practices and supports informing consumers about the terms of their mortgage loans, but worries about potential federal overreach.

"We're concerned that some of the CFPB's new requirements are not expressly mandated by Dodd-Frank and could lead to further consolidation in the servicing industry, increasing the cost of credit and harming borrowers," says Frank Keating, head of the American Banking Association.

Debra Still, chairman of the Mortgage Bankers Association, also has concerns. "Ultimately, the final verdict on this rule will be made by the market. We believe the rule will effectively block the return of risky product features and inadequate documentation. If it also provides lenders the certainty needed to originate qualified mortgages broadly across the market to creditworthy borrowers, it will have been a success. However, if the result is a tightening of credit as lenders pull back from offering loans that would create greater risk of litigation, the CFPB may need to quickly revisit the rule to avoid harming the housing recovery."

Representative Joe Atkins (D) Minnesota

The response from state policymakers has been mixed, with a sense of relief that at least the rules are out. "Many states hit the 'pause' button in our own consumer protection efforts in this arena, at least to some extent, while awaiting rules from the CFPB," says Minnesota Representative Joe Atkins (D).

Representative Chris Perone (D) Connecticut

"The new rules face a big challenge. Attempting to strike a balance between reining-in the potential for aggressive lending abuses that contributed to the meltdown on the one hand and being too restrictive for first time home buyers on the other," says Connecticut Representative Chris Perone (D). "New state laws created in the wake of the meltdown will also affect how that balance is achieved—on a state-by-state basis."