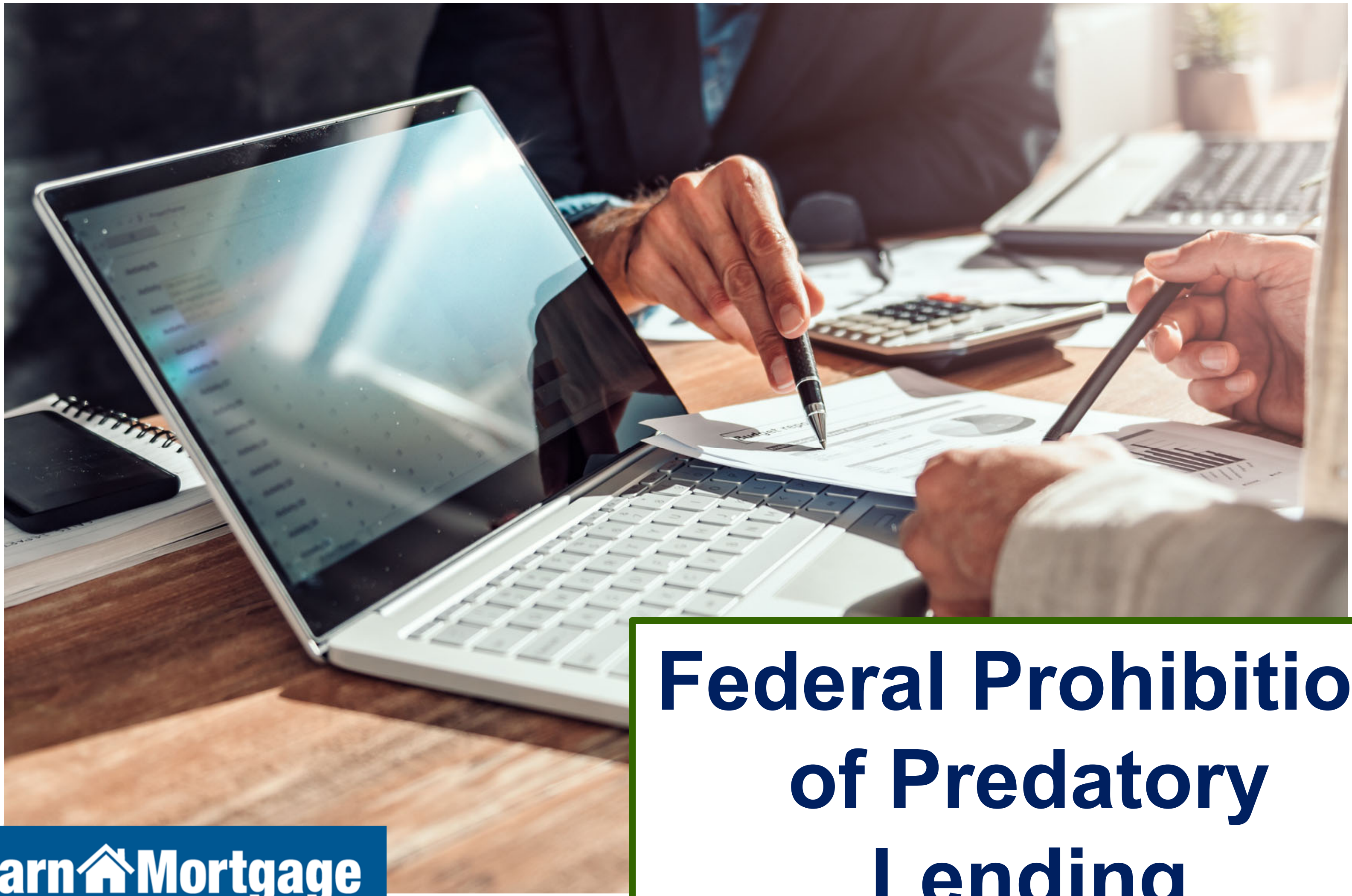
Chapter 9



Federal Prohibition of Predatory Lending

Learn Mortgage

Chapter Objectives

- Describe regulations designed to address predatory lending
- Describe the rules for compensation for an MLO and a registered MLO
- Discuss the rules regarding seller financing of owner-occupied residences

Home Ownership and Equity Protection Act

- **About HOEPA**
  - 1994 amendment to TILA; implemented by Reg Z
  - Establishes disclosure requirements and prohibits deceptive and unfair practices in lending
  - Establishes requirements for loans with high interest rates and/or fees
  - Enforced by FTC (non-depository lenders), state attorney generals, and CFPB (federally-regulated depository institutions)
  - Lender who violates may be sued by consumer or consumer may rescind loan for up to 3 years

12 CFR, Part 1026, Subpart E

HOEPA - High-Cost Loans

- **High-Cost Loan** (Section 32 Loan)
  - A closed-end loan secured by a borrower's principal residence
  - Includes purchase-money mortgages, refinances, closed-end home equity loans, and HELOCs
  - Exemptions: Most reverse mortgages, construction loans, HFA and USDA loans, loans made on second homes, and vacation homes
  - Must comply with HOEPA high-cost loan provisions if one/more triggers are met

12 CFR, § 1026.32

HOEPA - High-Cost Loans

- **HOEPA High-Cost Loan Triggers**
  - First lien: APR that exceeds value of APOR Index by more than 6.5 percentage points
  - Second mortgage: APR that exceeds value of APOR Index by more than 8.5 percentage points
  - Total loan amount is $22,969 or more: points and fees amount exceeds 5% of total loan amount
  - Total loan amount is < $22,969: points and fees amount exceeds lesser of adjusted points and fees dollar trigger of $1,148 or 8% of total loan amount

12 CFR, § 1026.32

HOEPA - High-Cost Loans

- **HOEPA High-Cost Loan Disclosures**
  - Delivery
    - 3 business days prior to consummation
  - Disclosure Notice
    - Protects consumers from pressure tactics that imply the consumer is already locked into the agreement or that canceling is complex or expensive
  - Disclosure Requirements
    - APR, regular payment amount, and loan amount
    - For variable rate loans, amount of the maximum monthly payments
    - For mortgage refinancing, total amount borrowed

HOEPA - Higher-Priced Loans

- **HOEPA Higher-Priced Loan Triggers**
  - Closed-end mortgage loans that are secured by the borrower's principal dwelling
  - The APR exceeds the average prime offer rate by:
    - 1.5 % for first lien mortgage
    - 2.5% for first lien jumbo loan (loan amount >$647,200)
    - 3.5% for a subordinate mortgage lien

12 CFR, § 1026.35

HOEPA - Higher-Priced Loans

- **HOEPA Higher-Priced Loan MLO Requirements**
  - Establish borrower's ability to repay
  - Establish an escrow account for property taxes, homeowner's insurance, private mortgage insurance, etc. for a 5-year term
  - Completion of a full appraisal with a physical visit of the interior of the property performed by a certified or licensed appraiser; an additional appraisal may be required if the property was acquired less than 180 days prior to the sales contract

12 CFR, § 1026.35

HOEPA - Prohibited Loan Terms

- **Prohibited Terms for HOEPA Triggered Loans**
  - No balloon payment on loans with term of < 5 years, unless a bridge loan of < 1 year
  - No negative amortization
  - No repayment schedule that consolidates more than 2 periodic payments that are paid in advance from the loan proceeds
  - No default interest rates that are higher than pre-default note rates and increase due to a default
  - No rebating a refund calculated by a method less favorable

12 CFR § 1026.32

HOEPA - Prohibited Loan Terms

- **Prohibited Terms for HOEPA Triggered Loans**
  - No prepayment penalties; exceptions:
    - First 2 years of the loan
    - The source of the prepayment funds is a refinancing by the lender or lender affiliate
    - The amount of the periodic payment of principal, interest, or both will not change at any time during the first 4 years of the loan
    - Borrower's debt-to-income ratio does not exceed 50%
  - No demand clauses that enables creditor to call the loan due before maturity

12 CFR § 1026.32

HOEPA - Prohibited Loan Terms

- **Prohibited Creditor Practices for HOEPA Triggered Loans**
  – No disbursement of proceeds from home improvement loans to anyone other than the borrower, jointly to the borrower and home improvement contractor, or, in some instances, to a third-party escrow agent
  – No selling/assigning loan without furnishing required statement to the purchaser/assignee
  – No refinancing a high-cost loan into another high-cost loan within the first 12 months of origination unless the new loan is in the borrower's best interest
  – No extending credit without required certification of pre-loan counseling

12 CFR § 1026.34

9.1 Knowledge Check

A higher-priced mortgage loan is defined as a loan where the APR, as disclosed by the Truth In Lending statement, of a mortgage loan exceeds the average prime offer rate by _____ for a first mortgage lien.

A. 1.0%

B. 1.5%

C. 2.5%

D. 3.5%

HOEPA - Prohibited Acts

- **Prohibited Creditor Practices for HOEPA Triggered Loans**
  - No granting loans solely on the collateral value of the borrower’s property without regard to borrower’s ATR
  - No recommending default to be refinanced by high-cost mortgage loan
  - No charging any fees to modify, defer, renew, extend or amend a high-cost mortgage; no late fees in excess of 4% of past due payments or pyramid late fees
  - No charging fee for generating payoff statements, with limited exceptions.
  - No finance lender points and fees into the loan

12 CFR § 1026.34

HOEPA – ATR Verification

- **ATR Requirements**
  - Similar, but not same, as Dodd-Frank
  - Income and Assets Inclusion
    - Expected income or assets
    - Tax returns and W-2s
    - Payroll receipts
    - Financial institution records
    - Other third-party documents that provide reasonably reliable evidence of the consumer's income or assets

12 CFR § 1026.43

HOEPA – ATR Verification

- **ATR Requirements**
  - Must use the largest payment of principal and interest scheduled in the first 5 years following consummation
  - Must take into account one of the following:
    - Ratio of total debt obligations to income
    - Income the consumer will have after paying debt obligations

12 CFR § 1026.43

HOEPA - Escrow Restrictions

- **Escrow Account**
  - Must establish and maintain an escrow account for property taxes and insurance, unless exempt
- **Escrow Account Cancellation**
  - May cancel borrower’s escrow account
    - Termination of the underlying debt, or
    - At least 5 years after consummation upon receiving a request to cancel from the consumer as long as the principal balance has been reduced to 80% of original value of property and loan is current

12 CFR, Part 1026, § 1026.35

HOEPA – Appraisal Requirements

- **Higher-Priced Loan Appraisal Requirements**
  - Use licensed/certified appraiser; prepares written report based on physical inspection
  - Disclose purpose of appraisal and provide free copy of any appraisal report a minimum of 3 days prior to close of escrow
  - For property seller acquired for lower price during the prior 6 months, a second appraisal is required if:
    - The price difference exceeds 10% of the seller's original acquisition cost during the first 90 days
    - The price difference exceeds 20% of the original cost during the first 91-180 days

12 CFR § 1026.35

HOEPA – Appraisal Requirements

- **Higher-Priced Loan Appraisal Requirements**
  - Exemptions
    - Qualified mortgage
    - Temporary bridge loans (12 month term or less)
    - Construction loan
    - Loan for new manufactured homes
    - Loan for mobile homes, trailers, and boats that are dwellings
    - Loans below the loan amount threshold for HPML
  - Exemption from 2nd appraisal
    - Loans in rural areas, government, and non-profit

12 CFR § 1026.35

9.2 Knowledge Check

When a seller owns a property that is to be resold during the first 90 days, a second appraisal is required for a conventional loan if the increase in price is

A. 5%.

B. 6.5%.

C. 9.99%.

D. 12.5%.

Loan Originator Compensation Rule

- **Purpose**
  - Address perceived unfair practices by MLOs related to compensation paid by consumers
- **Application**
  - Applies to transactions involving closed-end extensions of credit secured by a consumer's principal dwelling and must be followed by all persons who originate loans
- **Prohibition**
  - Cannot be compensated for loan origination activities based on any other loan term other than the loan amount

12 CFR § 1026.36

Loan Originator Compensation Rule

- **Allowable Compensation Triggers**
  - Flat fee fixed in advance
  - Hourly rate for time worked
  - Overall loan volume
  - Long-term loan performance
  - Existing/new customer
  - Pull-through rate; i.e., quality of loan files
- **Minimum/Maximum Compensation Limits**
  - Allowable as long as the amount is the same for every transaction

12 CFR § 1026.36

Loan Originator Compensation Rule

- **Dual Compensation**
  - MLO may not receive compensation from another person in connection with the same transaction
- **Yield Spread Premium**
  - Shown as borrower credit on LE; not considered compensation paid to MLO
- **Record Requirement**
  - Retain evidence of compliance for 3 years

12 CFR § 1026.36

Loan Originator Compensation Rule

- **Prohibitions to Prevent Evasion of Rule**
  - Compensation cannot be:
    - Based on a proxy for a term of a transaction
    - Reduced to offset the cost of change in transaction terms
    - Given to mortgage entity organization for referring a borrower to a service provider
    - Based upon the profitability of a transaction or a pool of transactions
  - MLOs may only be compensated from the loan originator organization

12 CFR § 1026.36

Loan Originator Compensation Rule

- **Bonus Compensation and Non-Deferred Compensation Plans**
  - Mortgage-related business profits can be used to make bonuses and contributions to other plans; must not exceed 10% of the individual MLO's total compensation
- **Tax-Advantaged Deferred Compensation Methods**
  - Defined contribution plan: Employee contribution to plan that is a designated tax-advantaged plan
  - Define benefit plan: A designated tax-advantaged/pension plan with sole contributions and control coming from the employer

12 CFR § 1026.36

Loan Originator Compensation Rule

- **Non-Deferred Profit-Based Compensation Plan**
  - An individual MLO may be paid variable, additional compensation based in whole or in part on the mortgage-related business profits of the person paying the compensation, any affiliate, or a business unit in the person's or the affiliate's organization
  - Examples of type of compensation: Bonus pools, profit-sharing, or awards of merchandise, trips, etc.
  - Requirements:
    - Bonus must not exceed 10% of MLO's gross pay for previous year
    - MLO originated 10 or fewer transactions during 12-month period preceding date of compensation determination

12 CFR § 1026.36

9.3 Knowledge Check

Which of the following may an MLO's compensation be based?

A. APR
B. a flat fee fixed in advance
C. loan program type
D. long-term loan performance
E. overall loan volume

Loan Originator Compensation

- **Steering**
  - Prohibited
  - Influencing, advising, counseling, directing consumers to accept the terms offered by a particular creditor in order to receive greater compensation than might be available from a different creditor, unless the loan is actually in the borrower’s interest

12 CFR § 1026.36

Loan Originator Compensation Rule

- **Safe Harbor from Steering Violations**
  - Obtain loan options from 3 or more reliable creditors
  - For each loan option the customer expresses an interest in, present:
    - Lowest interest rate
    - Lowest interest rate without risky features
    - Lowest total dollar amount for origination fees and discount points

12 CFR § 1026.36

9.4 Knowledge Check

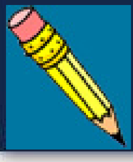
For an MLO to ensure he meets "safe harbor" requirements specific to this rule, an MLO must present, for each type of transaction, which of the following loan options?

A. lowest interest rate
B. lowest rate without risky features
C. lowest total dollar amount for origination fees
D. lowest total dollar amount for discount points

Loan Originator Compensation Rule

- **Registered MLO Guidelines**
  - Comply with state law requirements for legal existence
  - Ensure that each individual loan originator is licensed/registered under the SAFE Act
  - As required by SAFE Act, complete criminal and financial background checks and provide training
- **Written Policies and Procedures**
  - Must establish and maintain written policies and procedures to ensure and monitor for compliance

12 CFR § 1026.36



9.5 Apply Your Knowledge

A borrower applies for a $160,000 first mortgage loan to purchase a new home for $200,000 with a 20% down payment. His interest rate is 5%, the APOR (as of the date the loan interest rate is locked) is 4.672%, and his APR for this loan is calculated to be 6.474%.

9.5 Apply Your Knowledge

1. **Is this a higher-priced mortgage loan? Explain your answer.**

Yes

The APR is > the APOR threshold.

$$\begin{array}{r} 4.672 \\ \underline{+\ 1.500} \\ 6.172\% \end{array}$$

9.5 Apply Your Knowledge

2. If this loan is a higher-priced mortgage loan, what must be done?

- **Verify the borrower's ability to repay**
- **Establish an escrow account for 5 years**
- **Ensure loan meets HOEPA loan term requirements**

9.5 Apply Your Knowledge

3. **Based on the information provided, is this a high-cost loan? Explain your answer.**

No based on APR trigger

APR is < 11.172% (4.672% + 6.5%)

9.5 Apply Your Knowledge

4. **If the finance charges include one origination point, two discount points, and an additional $3900 in closing costs, using the provided information, is this a high-cost loan if it was a refinance transaction? Explain your answer.**

Yes

Total finance charges exceeds 5% of loan amount

9.5 Apply Your Knowledge

5. **If the loan is a high-cost loan, what must be done?**

Must provide borrower with HOEPA High-Cost Loan Disclosures within 3 business days prior to consummation

Chapter 9

Chapter Quiz

Chapter 9 Quiz

1. **The Home Ownership and Equity Protection Act amends which regulation?**
    - A. Regulation B
    - B. Regulation C
    - C. Regulation X
    - D. Regulation Z

Chapter 9 Quiz

2. **A pension plan with sole employer control of contributions is considered a(n)**
   A. defined benefit plan.
   B. defined contribution plan.
   C. employee benefit plan.
   D. employer contribution plan.

Chapter 9 Quiz

3. A higher-priced mortgage loan is a one that

A. has an APR greater than 6.5%.

B. includes finance charges greater than 5% of the loan amount.

C. is also known as a Section 32 loan.

D. uses the average prime offer rate as an index.

Chapter 9 Quiz

4. The borrower's ability to repay a mortgage loan may be based on

A. anticipated earnings from projected overtime pay.

B. current or expected income.

C. the equity in the subject property.

D. sporadic bonus income.

Chapter 9 Quiz

5. If a seller sells a home within three to six months after purchasing the home, a second appraisal is required for a higher-priced mortgage loan if the sale price exceeds the seller's acquisition price by more than

A. 5%.

B. 10%.

C. 20%.

D. 50%.

Chapter 9 Quiz

6. **A high cost loan is one that is defined as a mortgage loan (first lien) where the APR exceeds the average prime offer rate by**
   A. 4.0%.
   B. 5.0%.
   C. 6.5%.
   D. 8.5%.

Chapter 9 Quiz

7. Creditors must provide borrowers a copy of the appraisal used for their higher-priced mortgage loan _____ day(s) before the close of escrow.

A. 1

B. 2

C. 3

D. 5