

# Hot Topics in Consumer Mortgage Regulation and Licensing

November 2021

## Topics Discussed

- ***Consumer Mortgage Regulation for New Origination***
  - Origination Statutes (TILA/RESPA)
  - Consumer Financial Protection Bureau
  - COVID response
  - Credit Opportunity
- ***Consumer Mortgage Regulation for Seasoned Loans***
  - Federal and State High Cost Statutes
  - Missing Final HUD-1 and Final TILs
  - Potential Assignee Liability
- ***Ability to Repay Rule Developments***
  - Overview of the Ability to Repay Rule
  - Recent Developments

## Topics Discussed - Cont'd

- **Licensing**
  - Primary market, including mortgage loan originators
  - Secondary market
- **Examinations and Reporting**
  - Periodic reporting obligations of licensed companies
  - Examinations
- **Trends and developments**
  - COVID work-from-home rules
  - Offshore activities
  - Expanded use of shared databases/examinations (NMLS & SES)
  - Small business lending regulations

## 1. New Mortgage Originations

## Non-bank Mortgage Lenders

- Origination of Consumer Mortgage Loans by non-bank mortgage lenders
- Major inroads by non-bank lenders over the past decade.
  - Made up more than half of the mortgage market since 2016
  - Made 58.9% of all mortgages originated in 2019
  - Made 68.1% of all mortgages originated in 2020
- Four general origination channels
  - Distributed Retail, i.e., brick-and-mortar
  - Wholesale/brokered loans
  - Correspondent
  - Consumer Direct

## Mortgage Regulation - Federal Cont'd

- Mortgage Originations by non-bank lenders regulated on both a federal and state level
- Federal Regulation, including, but not limited to:
  - Truth-in-Lending Act ("TILA"), including Regulation X
    - Consumer Credit Disclosures
    - TILA-RESPA Integrated Disclosures
    - Ability-to-Repay/Qualified Mortgage Rule
    - Home Ownership and Equity Protection Act
  - Real Estate Settlement Procedures Act ("RESPA")
    - Servicing Regulation
    - Settlement Statements (GFE, HUD)
    - Section 8 Anti-kickback Provisions
  - Equal Credit Opportunity Act ("ECOA")

## Mortgage Regulation - Federal

- Federal Regulation cont'd:
  - Home Mortgage Disclosure Act (“HMDA”)
  - Fair Credit Reporting Act (“FCRA”)
  - Fair Debt Collection Practices Act
  - Gramm-Leach-Bliley Privacy Provisions, including Regulation P

## Mortgage Regulation - State

- State Regulation, including, but not limited to:
  - Interest and Usury
  - Mortgage Licensing Statutes
    - Including substantive requirements
    - Disclosure requirements
  - State Insurance Statutes Regarding Choice of Insurer
  - Anti-Predatory Lending Statutes

## Federal and State Regulators

- The Consumer Financial Protection Bureau (“CFPB”) is the primary federal agency administering the federal consumer financial laws.
  - Supervisory (examination) authority over banks, thrifts, and credit unions with assets over \$10 billion, as well as their affiliates
  - Supervisory authority over nonbank mortgage lenders of all sizes.
- State regulators generally include state Banking Departments and state Departments of Financial Institutions.

## CFPB COVID Response

- Federal Coronavirus Aid, Relief, and Economic Security Act passed March 27, 2020 (“CARES Act”)
  - Establishes a right to forbearance for up to 180 days with an additional 180 day extension for federally backed mortgages.
- CFPB has prioritized monitoring and oversight of mortgage servicing and servicers’ engagement with borrowers at all stages in the loss mitigation process.
- CFPB issued amendments to Regulation X in June 2020, which implements RESPA, to assist mortgage borrowers affected by COVID-19.
- CFPB issued further amendments to Regulation X in July 2021.

## CFPB COVID Response - Cont'd

- June 2020 Amendments included special deferral or partial claim options offered to borrowers affected by the COVID-19 pandemic exiting forbearance.
- July 2021 Amendments establish temporary procedural safeguards to help ensure that borrowers have a meaningful opportunity to be reviewed for foreclosure avoidance options before the servicer can make the first notice or filing for foreclosure on certain mortgages.
  - Temporarily permit mortgage servicers to offer borrowers certain streamlined modifications based on incomplete loss mitigation applications.
  - Amendments to the early intervention and loss mitigation reasonable diligence obligations ensure that servicers are communicating timely and accurate information to borrowers about their loss mitigation options

## CFPB Equal Credit Opportunity

- Biden Administration has been very focused on fair lending and equal credit opportunity issues
- CFPB has signaled that it will place greater emphasis on fair lending and efforts to address racial equity for underserved communities
- CFPB is adding 20 to 30 enforcement attorneys as it ramps up fair lending and redlining enforcement.

## 2. Seasoned Loans

### State and Local Predatory Lending Compliance Summary

- Anti-predatory lending laws are designed to protect borrowers from certain lending practices in connection with loans that, for example, charge borrowers fees or an APR, beyond certain stated thresholds.
- Generally, these state and local requirements are structured to include certain types of transactions, e.g. only refinance on primary dwellings, with fees, APR, or other features, such as prepayment penalties, beyond certain thresholds. If the applicability criteria and threshold elements are met, the loan is subject to certain prohibited terms, acts or practices may apply, e.g. "high-cost," "covered," "higher-priced loans".
- In some states, general categories of loans that do not have applicable thresholds will nonetheless have prohibited terms, acts or practices, e.g. "home loans."

## Example: Federal HOEPA

### High-Cost Mortgage Loan Requirements Summary

#### Thresholds

- APR Test - 1st liens: (1) Annual percentage rate ("APR") exceeds the applicable average prime offer rate ("APOR") by more than 6.5%, OR (2) if personal property AND Loan Amount is < \$50,000, by more than 8.5%
  - (Note: 10/1/95 to 9/30/02 compare APR to 10% + Treasury yield on 1st and subordinate liens; 10/1/02 to 1/9/14 compare APR to 8% + Treasury yield on 1st liens, 10% + Treasury yield on subordinate liens)
- APR Test - Subordinate liens: APR exceeds the applicable APOR by more than 8.5%;
- Points and Fees Test - Points and fees exceed 5% of the total loan amount OR for loans below \$20,000, the lesser of 8% of the total loan amount or \$1,000 (with the dollar figures also adjusted annually for inflation)
  - (Note: 10/1/95 to 1/9/14, Points and Fees exceed 8% of the total loan amount for 1st and subordinate liens); or
- Prepayment Penalty Test (on or after creditor application dates of January 10, 2014) – Loan permits a prepayment penalty more than 36 months after transaction closing (or for an open-ended account, the account opening) OR permits such penalty to exceed, in the aggregate, more than 2% of the amount prepaid.

If a loan is a High-Cost Mortgage, certain Prohibited Terms, Acts or Practices Apply

## Missing Final HUD-1 or TIL

- There is no secondary market liability under RESPA for missing a HUD-1
- A missing final HUD-1 is significant because without it, it can be difficult, if not impossible, to determine the high cost status of a loan.
  - Estimated HUD-1s are useful if a final HUD-1 is unavailable, but leaves open the possibility that fees may be incorrect or missing.
- A missing final TIL on the other hand, should not cause issues for seasoned loans because the affirmative statute of limitations will generally have expired for such loans.

## Potential Assignee Liability

- Assignee liability for seasoned loans is comprised of the following:
  - Potential recoupment or setoff liability under TILA.
  - Potential liability under federal, state or local high cost statutes.
  - High Cost statutes may contain specific statutes of limitation or in their absence, general written contract statutes of limitation are applied.
    - Most written contract statutes of limitation are limited to 6 or 7 years
    - However, some states can be much longer. For instance, Kentucky's SOL can be up to 15 years for contracts prior to July 5, 2014.

## How can a secondary market participant apply compliance applicability and liability criteria to aid in the review of loan level due diligence?

- “Applicability criteria” means the characteristics and details of a loan at origination that may subject the loan to compliance testing, including an anti-predatory lending compliance review.
  - These characteristics are:
    - Application date or Consummation/Note Date
    - Loan Purpose, e.g. Purchase, Refinance;
    - Loan Amount;
    - Loan Type, e.g. conventional, FHA;
    - Occupancy, e.g. primary, second home, investor;
    - Closed end, open end credit, reverse;
    - Security for loan, e.g. real property;
    - Units; and
    - State and locality
- Use of the compliance testing applicability criteria is an effective means to prioritize a review of compliance due diligence results.
- In connection with a particular compliance requirement, generally, if the applicability criteria are not satisfied, then the loan will not be subject to that testing, and in turn, purchasers of the loan will not be at risk for the potential liability related to the compliance requirement for that particular loan (where assignee liability may attach for violations).
- Where a loan does not have sufficient documentation to determine, for example, the final fees payable in connection with the loan, a purchaser may review to determine if the loan satisfies the relevant applicability criteria.
- If Yes, a purchaser may look to determine if the inability to perform applicable testing is material depending on whether the requirement carries assignee liability.
- The following slide contains fields that a purchaser can request from its due diligence vendors to aid in its prioritization of loan reviews.

### 3. Ability to Repay/ Qualified Mortgage Rule

#### The Ability to Repay and Qualified Mortgage Rule

- In response to the financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) amended the federal Truth-in-Lending Act (“TILA”) to add the ATR rule.
- The ATR rule became effective for all loan applications taken on or after **January 10, 2014**.
- The ATR rule generally applies to any consumer credit transaction that is secured by a dwelling:
  - Applies to both purchase money mortgages and refinances
  - Applies to loans secured by primary dwellings as well as secondary dwellings (vacation homes).

## The Ability to Repay and Qualified Mortgage Rule

- The ATR Rule generally requires creditors to **make a reasonable, good faith determination of a borrower's ability to repay their mortgage according to its terms.**
- Creditors must consider **8 general underwriting factors** as discussed below in making the determination of whether a consumer has a reasonable ability to repay the loan.
- Whether a particular determination is reasonable and in good faith depends upon the creditor's underwriting standards, the facts and circumstances of the particular credit extension, and the creditor's application of its underwriting standards to those facts and circumstances.
- In lieu of the 8 general underwriting factors, creditors may instead make a specific type of loan, called a "qualified mortgage". If creditors meet the specific requirements of a "qualified mortgage," the creditor will be **presumed to comply with the general ability to repay standard** and depending on the annual percentage rate ("APR") of the loan, enjoy either a safe harbor from liability or a rebuttable presumption of compliance.
- Note that as result of amendments to the ATR Rule, for applications received on or after March 1, 2021, creditors may make QMs under the "old" or "new" definitions, until October 1, 2022, at which point compliance with the "new" QM definition becomes mandatory.

## The Required Ability to Repay Underwriting Factors

Under the general ATR rule, the creditor must consider the following eight (8) factors during the underwriting process:

1. Current or reasonably expected income or assets (other than the value of the dwelling, including any real property attached to the dwelling);
2. Current employment status if the creditor relies on income from the consumer's employment in determining repayment ability;
3. The monthly payment, calculated using the greater of a fully-indexed rate or any introductory rate and using monthly, fully amortizing payments that are substantially equal. Special rules apply for loans with certain product features;
4. Simultaneous loans secured by the same dwelling that the creditor knows, or has reason to know, will be made;

## The Required Ability to Repay Underwriting Factors

5. The monthly payment for “mortgage related obligations” (*i.e.*, property taxes, insurance premiums and similar charges required by the creditor, fees and special assessments imposed by a condominium, cooperative or homeowners association, ground rent, and leasehold payments);
6. Current debt obligations, alimony, and child support;
7. The monthly debt-to-income ratio (*i.e.*, ratio of total monthly debt obligations to total monthly income) or residual income; and
8. Consumer’s credit history.

## Definition of a Qualified Mortgage (New)

Generally, to be considered a Qualified Mortgage, the loan must:

1. Provide for regular, substantially equal, periodic payments (other than ARM or step-rate adjustments);
2. Not have the potential for negative amortization;
3. Not be an interest-only loan;
4. Not include balloon payments;
5. Not exceed 30 years;
6. Not have points and fees (as defined under 2014 HOEPA) exceeding 3% of total loan amount for loans of \$100,000 or greater or other specified thresholds for lower amounts;
7. Be underwritten by the creditor, taking into account the monthly payment for mortgage-related obligations, using:
  - a) The maximum rate that may apply during the first five years of the loan; and
  - b) Periodic payments of principal and interest that will repay either the outstanding balance over the remaining term of the loan as of date the interest rate adjusts to the maximum rate, or the loan amount over the term.

## Definition of a Qualified Mortgage (continued)

8. The creditor must consider and verify current and reasonably expected income and assets, debt obligations, alimony, and child support, and monthly debt-to-income ratio.
9. The APR of the loan may generally not exceed the average prime offer rate for a comparable transaction as of the date the interest rate is set by:
  - 2.25% or more for first lien loans; and
  - 3.5% or more for subordinate lien loans.
- Significantly, other than for points and fees violations, if a technical error is made when originating a QM such that a QM requirement is not met, the lender may not "cure" the loan after closing so that it remains a QM. The loan would be considered a non-QM if the lender properly considered the 8 underwriting factors of the ATR rule.
- The Department of Housing and Urban Development and the Department of Veterans Affairs have each issued its own rule that defines a QM.

## Qualified Mortgage - Safe Harbor vs. Rebuttable Presumption

If the loan satisfies the above QM requirements, the loan is either a Safe Harbor QM or Rebuttable Presumption QM.

- Generally, if the APR exceeds the average prime offer rate ("APOR") by 1.5 or more percentage points for first-lien or by 3.5 or more percentage points for subordinate-lien, then the loan is a Rebuttable Presumption QM. Otherwise, the loan is a Safe Harbor QM.
- **Safe harbor.** If the loan is Safe Harbor QM it will be conclusively presumed that the creditor made a good-faith and reasonable determination of the consumer's ability to repay. Even under the safe harbor, however, a consumer may challenge a determination that the loan met the criteria for a QM.
- **Rebuttable Presumption QM.** If the loan is Rebuttable Presumption QM, there is a rebuttable presumption that the creditor made a good-faith and reasonable determination of the consumer's ability to repay. Consumers may rebut the presumption by showing that, at the time the loan was originated, the consumer's income and debt obligations left insufficient residual income to meet living expenses.
- There is no presumption of compliance with the ATR rule for non-QM loans.

## Qualified Mortgage - Recent Developments

- Verification Safe Harbor
  - GSE and Government Guides dated as of June 3, 2020
  - Meaning of “Substantially Similar”
- Treatment of Non-QM loans under the Amended Qualified Mortgage Definition
  - Bank Statement Loans

## 4. Licensing

## SAFE Act and the NMLS

- Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act)
  - Supervised financial institutions (i.e., banks, credit unions) and their subsidiaries engaged in mortgage lending
  - Non-bank mortgage lenders
  - Individuals within licensed/registered companies that engage in mortgage origination activities
    - Takes an application for a mortgage loan
    - Negotiates the terms and conditions of a mortgage loan
- Unified system of mortgage lending regulation: Nationwide Mortgage Licensing System & Registry (“NMLS”)
  - Shared database for licensing administration and supervision
  - Certain information publicly available through NMLS Consumer Access (similar to FINRA’s BrokerCheck)
- Each state required to enact laws that implement SAFE Act licensing requirements — but no two are the same.
  - Determined by the jurisdiction of the loan or service provided, not the company’s home office.

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## NMLS Beyond Mortgage Lending & Brokering

- NMLS is seen as successful
  - Ease of administration for state and federal regulators
  - Streamlining of existing licensing administration for lenders
    - Less paper and duplication of work across different state licenses
  - No new mortgage-related financial crisis.
- Other financial services licensing is added onto the NMLS
  - Commercial mortgage lending
  - Mortgage servicing
  - Sales finance lending and other consumer lending
  - Student loan lending & servicing
  - Debt collection & credit repair
  - Money service business (money transmission, virtual currency trading services)
  - Pawn brokering, ATM licensing, etc.
- NMLS re-named "Nationwide *Multistate* Licensing System & Registry"
- Not all states license all activities
- Not all states use NMLS for administration of additional license types.

## Secondary Market Licensing

- Secondary market participants acquire loans for investment purposes but do not engage in any direct lending, brokering, servicing, etc.
  - All borrower-facing activities are contracted out to other licensed parties.
- Some states require that secondary market participants obtain licenses as lenders, servicers, and/or debt collectors.
  - In a few instances, this forces individuals to also obtain related licenses as part of licensing process.
- States have different levels of understanding of and accommodation for differences between primary and secondary market participants.

## What Is Needed to Get a License?

- Company information
  - Formation documents, Federal tax ID number
  - Registration in good standing with state's secretary of state
  - Disclosure of parent companies and ownership, management chart
  - Financial statements
    - Some states require financial statements to be audited
    - Some states have minimum net worth requirements (as high as \$250,000)
  - Surety bond (\$5,000–\$500,000 of coverage, depending on state and activity)
  - Fidelity bond and errors & omissions insurance
- Control persons of company & licensed individuals
  - Fingerprinting for criminal background check
  - Credit check
  - Resume/employment history disclosures
  - Loan Originators: pre-licensing education and licensing exam
- Disclosure of criminal, civil and regulatory actions

## 5. Examinations and Reporting

## Post-Licensing Obligations

- Periodic reporting for licensed companies
  - Mortgage lenders, brokers and servicers are required to file a quarterly mortgage call report showing breakdown of loan origination, portfolio, etc.
  - Annual financial reporting
  - State-specific annual reports and questionnaires
- Annual continuing education for licensed individuals
  - Minimum of 8 hours. Some states have additional requirements
- Event-driven notification
  - Change of disclosed officers
  - Change of office address
  - Change of name
  - Change of 10%+ ownership
  - Material events
    - Bad acts, net worth changes, etc.

## License Examinations

- Essentially all states have statutory authority to perform periodic routine examinations of a licensee's business.
  - Varying degrees of rigor and sophistication across state examination regimes
  - Varying degrees of frequency: Some states methodically conduct exams every second year while others perform examinations only infrequently. Partly dictated by perceived risk.
- State regulator (or attorney general) may also conduct examinations in response to consumer complaints
- Examination can review essentially any aspect of licensed business
  - For lenders, brokers, servicers and secondary market companies, this can include review of loan files.

## 6. Trends and Developments

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### The Rise of Remote Work

- Most statutes, regulations and state policies were conceived in an era of paper loan documents, physical offices, and walk-in (or call-in) customers
- During COVID-19 pandemic lockdowns, states adopted emergency provisions to allow employees to work from home
  - some states have made remote working permanent
  - Some states have allowed homes to be designated as “branch offices”
  - This creates new data privacy/security, supervision and consumer protection concerns
- Offshore Activities
  - Offshore call centers, loan processing and other activities performed offshore may trigger licensing requirements
  - More states are permitting licensed activities to be performed outside of US
  - Complications arise regarding supervision, books and records storage, and individual background checks

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## Expanding Use of Shared Databases

- States continue to move additional licensed activities from paper licenses or proprietary systems onto the NMLS
  - Collection agency, student loan servicer and money transmission activities all moving onto the NMLS
  - California is requiring all finance lender licenses to become managed through the NMLS by December 31, 2021
  - California adopted Debt Collection Licensing Act (SB 908) in 2020 to create new collection agency licensing requirement, to be administered through NMLS
- Creation of State Examination System (SES)
  - System similar to the NMLS but created for state regulators to receive consumer complaints, share license examination activities and conduct joint examinations
  - Launched in 2020 and likely to be adopted in full by all states
  - May lead to less arduous but more frequent license examinations

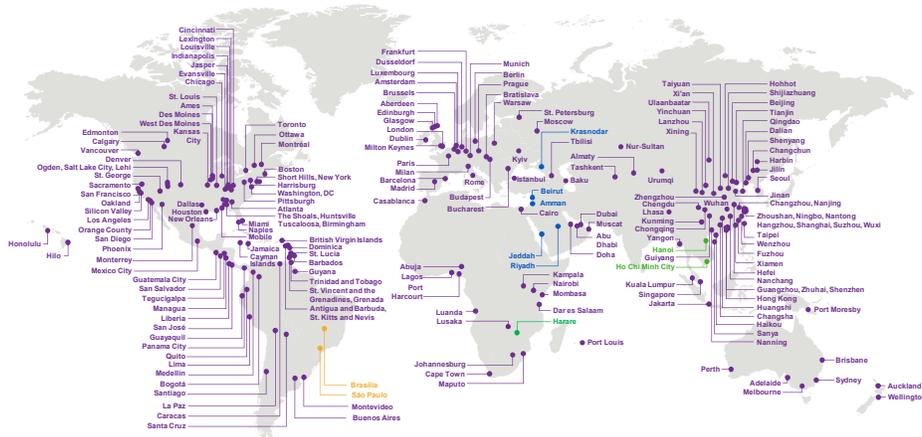
## Small Business Lending Regulation

- Section 1071 of the Dodd-Frank Act
  - Require financial institutions to collect and report certain data in connection with credit applications made by women- or minority-owned businesses and small businesses.
  - Not implemented under Obama & Trump administrations.
  - September 1, 2021, CFPB notice of proposed rulemaking to implement Section 1071.
  - Proposed rule includes non-loan products (e.g., factoring, merchant cash advances).
- California (SB 1235)
  - Requires disclosures to for commercial financing products, including small business loans and merchant cash advances. Commercial mortgages exempt.
  - Aim is to provide small business borrowers ability to perform apples-to-apples comparisons between financing options.
  - Third modification of proposed rules released October 12, 2021, with public comments due by October 27, 2021.
- New York (S.B. 5470B, S.B. 898)
  - Non-bank financial institutions must provide TILA-type disclosures to small business commercial financing transactions. Commercial mortgages exempt.
  - Proposed rules likely to take effect mid-2022.

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