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Regulation Z High-Cost Mortgages and Homeownership Counseling

The Consumer Financial Protection Bureau (CFPB) has amended Regulation Z expanding the coverage of the Home Ownership and Equity Protection Act (HOEPA) and adding protections for high-cost mortgages. This rule also includes a requirement for borrowers to receive homeownership counseling before obtaining a high-cost mortgage. Counseling requirements and encouragement also apply to other types of loans.

Updated Alert Date: December 31, 2013

Status: Effective January 10, 2014

Links: [Final Rule - 01/31/13](#)
[Final Rule - 09/12/13](#)
[Interim Final Rule - 10/23/13](#)
[Final Rule - 11/14/13](#)
[Final Rule - 12/16/13](#)

Pursuant to Dodd-Frank, the CFPB has issued a final rule amending Regulation Z. This rule amends Regulation Z by expanding the types of mortgage loans that are subject to the protections of HOEPA, revising and expanding the tests for coverage under HOEPA, and imposing additional restrictions on these loans, which include a requirement for homeownership counseling. The most recent amendments provide for the following:

- **10/23/13 Final Rule** – This rule clarified the specific disclosures that must be provided *before* counseling for high-cost mortgages can occur. Prior to this new rule, 1026.34 required that counseling occur after the consumer receives the initial disclosure under RESPA or the Reg. Z disclosures for open-end credit under 1026.40. However, this new rule addresses the handling of loans that may not fit into either category, i.e. closed-end non-RESPA loans. For those loans, this rule clarified that counseling must occur after the consumer receives the HOEPA disclosure required by 1026.32(c).
- **11/14/13 Final Rule** – This rule described data instructions for lenders to use in complying with homeownership counseling amendments related to providing a homeownership counseling list.
- **12/16/13 Final Rule** – This rule adjusted the statutory fee trigger for HOEPA loans to \$632, effective January 1, 2014. This will apply to loans closed on or after January 1, 2014, and will apply **UNTIL** the revised HOEPA fee trigger takes effect, as discussed below.

What Transactions Are Covered By The HOEPA Rules?

This rule applies to loans for which you receive an application on or after January 10, 2014. For credit transactions that are secured by a consumer's principal dwelling, a determination must be made to ascertain if the loan is covered by HOEPA. If the loan meets any of the coverage tests, a lender must comply with the high-cost mortgage rules. The transactions that could potentially be affected include:

- Purchase-money mortgages
- Refinances
- Closed-end home equity loans and open-end credit plans (HELOCs)

Regulatory Note: As the high-cost rules will now cover HELOCs, Regulation Z Section 1026.32 is being renamed "Requirements for high-cost mortgages" (instead of "Requirements for certain closed-end home mortgages").

The HOEPA rules exempt certain transactions such as: reverse mortgages, construction loans (to finance initial construction), loans originated and financed by the Housing Finance Agency and loans originated and financed under the USDA's rural development section 502 direct loan program.

What Are The Tests That Determine Coverage?

Determination of whether a consumer credit transaction secured by a consumer's principal dwelling is a high-cost mortgage is based on the application of three tests. As reflected in the following chart, these tests are focused on the annual percentage rate, points and fees and prepayment penalties.

Annual Percentage Rate (APR)	Points and Fees	Prepayment Penalties
<p>Applies if the APR exceeds the APOR* for a comparable transaction by more than:</p> <ul style="list-style-type: none"> - 6.5 % points for 1st lien loans (generally) - 8.5 % points for 1st lien loans that are for less than \$50,000 and secured by personal property (e.g., manufactured homes titled as personal property) - 8.5% for junior-lien loans <p><i>* The APOR is the average prime offer rate as defined within the regulation. It is an APR that is derived from average rates, points & other loan terms currently offered by a representative sample of creditors, which is published periodically. A comparable transaction (also defined in the regulation) is one that closely resembles the institution's transaction, based on a variety of factors such as the date the rate is set, fixed or variable rate plans and term of the loan.</i></p>	<p>Applies if the transaction's total points and fees* exceed the following:</p> <ul style="list-style-type: none"> - 5% of the total loan amount (for loans greater than or equal to \$20,000) - 8% of the total loan amount or \$1,000 (whichever is less) for a loan amount less than \$20,000 <p><i>Note: the \$20,000 and \$1,000 amounts will be adjusted annually.</i></p> <p><i>* An extensive discussion of points and fees to be included or excluded is included within the regulation in 1026.32(b)</i></p>	<p>Applies if a prepayment penalty* is charged:</p> <ul style="list-style-type: none"> - More than 36 months after closing or account opening, or - Total prepayment penalties exceed 2% of any amount prepaid. <p><i>* A discussion of what is considered a prepayment penalty is provided within the regulation in 1026.32(b).</i></p>

What Provisions Apply to High-Cost Mortgages?

At a high level, the following provisions apply:

- Specific disclosure requirements
- Restrictions on terms, fees and practices
- Ability-to-repay requirements (*implemented in the CFPB's Ability-to-Repay / Qualified Mortgage final rule*)
- Pre-loan counseling

What Are The Disclosure Requirements For High-Cost Mortgages?

For covered loans, a lender must furnish required disclosures at least 3 business days prior to loan closing or account opening. While the current version of Regulation Z already contains some disclosure requirements, the required contents now include the following:

- A statement that the consumer is not required to complete the agreement and that if the loan is obtained, the lender will have a mortgage on the consumer's home, which the consumer could lose if they don't meet their obligations.
- The annual percentage rate
- Information on payments (regular, periodic and balloon)
- A variable rate statement
- The amount borrowed or the credit limit

What Are The Restrictions For High-Cost Mortgages?

While the current rules already provide certain restrictions and prohibitions that will remain unchanged, the rules now provide for:

- Prohibition on balloon payments, except in instances where 1) the payment schedule is adjusted to accommodate seasonal or irregular income, 2) the loan is a short-term bridge loan (12 months or less) to finance a new home purchase for a consumer selling an existing home, and 3) the creditor meets criteria for serving a predominantly rural or underserved area and the loan meets specific other criteria.
- Prohibition on prepayment penalties
- Prohibition on due-on demand features that allow acceleration of the mortgage, except in instances where: 1) the consumer has committed fraud or made a material misrepresentation in connection with the transaction, 2) the consumer defaults on payment, or 3) the consumer's action or inaction adversely affects your security interest.
- Prohibition on creditors and brokers recommending default on an existing loan to be refinanced by a high-cost mortgage.
- Prohibitions on charging a fee to modify, defer, renew, extend or amend a high-cost mortgage.
- Restrictions on late fees to 4% of the past due payment and prohibition on pyramiding.
- Restrictions on imposing a fee for payoff statements.
- Restrictions on financing certain points and fees.
- Prohibition on structuring a transaction to evade HOEPA coverage, for example, splitting a loan into multiple loans.

What Are The Homeownership Counseling Requirements?

First, a note about counseling-related disclosures...in conjunction with this rule amending Regulation Z, the CFPB also amended Regulation X (RESPA) to require that a list of homeownership counseling organizations be provided in connection with most applications for federally-related mortgage loans (regardless of whether the application involved a high-cost mortgage loan).

Under the new Regulation Z rule, however, pre-loan counseling is required in connection with certain loans, as follows:

- For high-cost mortgages:
 - A lender must receive written certification that the consumer has received homeownership counselor prior to making a high cost mortgage.
 - The counselor cannot be affiliated with your organization and a lender cannot steer a consumer to use a particular counseling agency.
- For other mortgages that are not high-cost, the following provisions apply:
 - For negative-amortization loans made to first-time borrowers, a requirement applies for pre-loan counseling

The counseling must take place *after* the consumer has received either the RESPA initial disclosure or the disclosures required by 1026.40 for home equity lines of credit (HELOCs). For transactions that not covered by RESPA or the HELOC rules, counseling must occur after the consumer has received the high-cost mortgage disclosures required by 1026.32(c).

Recommendations for Next Steps

By January 10, 2014:

1. Review Truth in Lending and/or other mortgage lending-related policies as they relate to HOEPA and high-cost mortgage loans. Resolve inconsistencies and update the requirements as outlined in the final rule.
2. Review mortgage-related procedures and update to address the new requirements and restrictions for high-cost mortgages. Make certain applicable procedures ensure:
 - a. Proper determination and identification of covered high-cost mortgages (*consider checking with your loan platform provider for automated solutions*)
 - b. Implementation of updated disclosures prior to closing
 - c. Review for compliance with prohibitions and restrictions
 - d. Review for requirements related to homeownership counseling
3. Review mortgage-related procedures and update to address the pre-loan counseling requirements for negative-amortization loans made to first-time borrowers.
4. Train applicable staff on the requirements of the final rule and internal policies and procedures.