

A Mortgage and Consumer Finance Law Update

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Mortgage Reform Bill Passes the House: Sweeping Changes to Federal Regulation Are on the Horizon

On November 15, 2007, by a vote of 291-127, the House of Representatives passed the Mortgage Reform and Anti-Predatory Lending Act of 2007 ("H.R. 3915"). Broad bipartisan support for the bill — 100 percent of Democrats and 67 percent of Republicans — ensures that sweeping changes to federal regulation in this area are a virtual certainty. The Senate is also expected to introduce a mortgage reform bill in the coming weeks. While the impending Senate bill and negotiations with the White House will likely produce some changes to this pending legislation, the key features of the House bill, outlined below, indicate the direction that it will take.

H.R. 3915 arose in response to the recent sub-prime mortgage crisis, its widespread impact on financial markets, and the resulting foreclosures of millions of consumer mortgages. Financial Services Committee Chairman Barney Frank described the bill's origins as follows:

We are dealing with legislation that seeks to prevent a repetition of events that caused one of the most serious financial crises in recent times. There is no debate about ... the largest single cause of that. Innovations in the mortgage industry ... are good and useful, but [some innovations] were conducted in ... a complete[ly] unregulated manner and led to this crisis.

The bill amends the Truth in Lending Act ("TILA") in order "to reform consumer mortgage practices, to provide accountability for such practices, to establish licensing and registration requirements for residential mortgage originators, [and] to provide certain minimum standards for consumer mortgage loans."

Key features of the final version of H.R. 3915 include:

- **Registration and Licensing.** H.R. 3915 would establish a national registry for all mortgage originators and require licensing of state-chartered mortgage originators. The bill's proponents deem these amendments central to redressing the perceived lack of oversight in the industry. However, the Nationwide Mortgage Licensing System and Registry would not directly or indirectly offer educational courses for pre-licensure or continuing education for mortgage originators.
- **National Standards.** Because the mortgage industry is currently characterized by a patchwork of conflicting and varying state laws, H.R. 3915 seeks to establish national standards regarding assignee and securitizer liability. However, the

various states will remain free to pass more stringent laws against lenders and loan originators.

- **Responsible Lending.** Seeking to reduce unreasonable consumer debt, the bill would establish minimum standards to ensure that borrowers have a “reasonable ability” to repay loans, and attaches a limited liability to secondary market securitizers.
- **High-Cost Loans.** The bill would strengthen the provisions of Section 32 of the Home Ownership and Equity Protection Act (“HOEPA”), which addresses certain deceptive and unfair practices in home equity lending, especially in high-rate, high-fee loans, and would establish an Office of Housing Counseling through the U.S. Department of Housing and Urban Development (“HUD”). Protections in this context include the lowering of points and fees and interest rate triggers, and prohibiting practices that increase the risk of foreclosure such as balloon payments, and other practices that encourage a borrower to default. The bill would also require more pre-loan counseling.
- **Anti-Steering.** Of particular concern to mortgage originators and brokers was the anti-steering language proposed in prior hearings. In the final bill, anti-steering language remains, but mortgage originators do retain the ability to earn origination fees, costs, and compensation that is financed by the consumer through interest rates or through the loan principal. The primary limitation here is that such compensation must be clearly disclosed early in the application process and cannot vary according to the type or terms of the loan, *i.e.*, it cannot be “incentivized compensation.” While the National Association of Mortgage Brokers (“NAMB”) believes that the hearings and the final bill may require further analysis, it appears that mortgage originators’ ability to earn clearly disclosed indirect compensation has been preserved.
- **Definitions.** The bill clarifies the definition of “loan originator,” and includes language proposed by NAMB regarding originators’ ability to earn indirect compensation.
- **ARM Notifications.** Loan creditors or servicers must provide written notice to consumers with hybrid adjustable-rate mortgages (“ARMs”) six (6) months before their interest rates are scheduled to reset. Such notice must include the new interest rate, an explanation of how the new rate will be determined, the creditor’s or servicer’s good faith estimate of the monthly payment that will apply after the reset, a list of alternatives the consumer may pursue before the date of the reset, and contact information for local HUD-approved housing counseling agencies and the state housing finance authority.
- **Secondary Markets.** The bill contains unprecedented provisions that would, in certain circumstances, hold Wall Street firms liable if they buy, sell or securitize loans that consumers cannot repay. Consumers will have rights of action against

this secondary market and may have their loans rewritten under certain circumstances.

- **Protection from Civil Liability.** Lenders would not face civil liability and borrowers would not have a right of rescission in cases where the borrower knowingly lied on a mortgage application.
- **Prepayment Penalties.** Borrowers who are offered mortgage loans carrying prepayment penalties would also have to be given the option of loans without such penalties. A three-year maximum would be established for any prepayment penalty, and such penalties are limited to 3% of the loan amount for the first year, 2% for the second year, and 1% for the third year.
- **FHA Exclusion.** Loans insured by the Federal Housing Administration (“FHA”) are excluded from the provisions of H.R. 3915.
- **Renters.** Renters are to be given proper notification of impending foreclosures, and they are to be given adequate time to relocate before the home they rent is foreclosed.
- **Education Requirements.** Educational requirements for loan originators must include instruction on fraud, consumer protection and fair lending issues.
- **GAO Study.** The U.S. Government Accountability Office (“GAO”) is directed to conduct a study to determine the effects that H.R. 3915 will have on the availability and affordability of credit for homebuyers and mortgage lending. The GAO is to submit its report to Congress within one year of the enactment of this legislation.

Resources

The final version of H.R. 3915 may be downloaded at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3915eh.txt.pdf.

For more information, please contact the Mortgage and Consumer Finance Law Industry Team at Lane Powell:

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