Mortgage Banking Update

PATTON BOGGS LLP | April 18, 2011

Powered by Patton Boggs' Mortgage Banking Team

IN THIS ISSUE:

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FED PROPOSES ABILITY TO REPAY RULES UNDER DODD-FRANK

On April 19, 2011, the Board of Governors of the Federal Reserve System (Fed) issued a proposed amendment to Regulation Z, the Truth in Lending regulation, to require creditors to determine a consumer's ability to repay a mortgage before making a loan, and to establish minimum mortgage underwriting standards. The proposal is made pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Comments are due July 22, 2011, and final rulemaking on this topic will be carried out by the Consumer Financial Protection Bureau.

The ability to repay requirement would apply to all consumer purpose mortgages except home equity lines of credit, timeshare plans, reverse mortgages and temporary loans.

The proposal presents four options for a creditor to comply with the ability to repay requirement. The first option would be a general ability to repay standard, where the creditor would consider and verify the following factors: (1) income or assets relied upon in making the ability to repay determination; (2) current employment status; (3) monthly payment on the mortgage; (4) monthly payment on any simultaneous mortgage; (5) monthly payment for mortgage-related obligations; (6) current debt obligations; (7) monthly debt-to-income (DTI) ratio or residual income; and (8) credit history. To meet the first option, underwriting the payment for an adjustable rate mortgage (ARM) would have to be based on the fully indexed rate.

The second option for compliance would be to originate a "qualified mortgage," and the Fed is seeking comments on two different definitions for "qualified mortgage." Creditors that complied with the first definition of qualified mortgage would receive a safe harbor. A loan would be considered a qualified mortgage under this definition if it did not contain negative amortization, interest-only payments, a balloon payment or a term in excess of 30 years and if: (1) total points and fees do not exceed three percent of the total loan amount; (2) income or assets relied on in making the ability to pay determination are considered and verified; and (3) underwriting of the mortgage is based on the maximum interest rate that may apply in the first five years, uses a payment schedule that fully amortizes the loan over the loan term and takes into account any mortgage-related obligations.

The alternative definition for qualified mortgage would include the elements in the first proposed definition and also require the creditor to consider and verify the: (1) consumer's employment status; (2) monthly payment for any simultaneous mortgage; (3) consumer's current debt obligations; (4) monthly DTI ratio or residual income; and (5) consumer's credit history. Meeting this definition would create a rebuttable presumption of compliance.

NEWS FROM THE HILL: HOUSE DISCUSSES PROPOSED RULE ON RISK RETENTION

On April 14, 2011, the House Committee on Financial Services, Subcommittee on Capital Markets and Government-Sponsored Enterprises held a hearing titled, "Understanding the Implications and Consequences of the Proposed Rule on Risk Retention." The hearing focused on the proposed rulemaking announced by various agencies, including the Board of Governors of the Federal Reserve System (Fed), the Office of the Comptroller of the Currency (OOC), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), the Federal Housing Finance Agency (FHFA) and the Department of Housing and Urban Development (HUD). This proposed rulemaking addresses Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which requires that a securitizer retain an economic interest in a material portion of the credit risk for any asset that it transfers, sells or conveys to a third party.

The hearing consisted of two panels. During the first panel, agency representatives talked about how the rule would align the incentives of investors and securitizers while lowering costs to borrowers. The agency representatives also answered questions regarding the definition and specific underwriting standards for qualified residential mortgages (QRMs), which would be exempt from risk retention requirements. The second panel consisted of private sector and community representatives, who focused on the potential negative effects of the proposed rule on the housing finance industry, lower income families and minorities. Additionally, the second panel talked about the various shortcomings of the proposed rule, including the exclusion of private mortgage insurance and various asset classes from the QRM exemption.

Throughout the hearing, Republicans expressed their concerns regarding two main aspects of the proposed rulemaking: the inclusion of servicing standards and the exemption from risk retention requirements for government-sponsored enterprises (GSEs). Separately, Democrats worried that the 20 percent down payment requirement included in the proposed rulemaking would negatively impact overall access to affordable housing. Of note, FHA Acting Commissioner Bob Ryan admitted that the QRM definition could result in restricting credit.

When Congress reconvenes, the House Financial Services Committee and the House Committee on Oversight and Government Reform are expected to continue discussions regarding GSE reform and the oversight and regulatory implementation of Title VII of the Dodd-Frank Act.

The Patton Boggs Financial Services Group is closely tracking these political developments and other regulatory developments coming from the Hill. Further information on each of these financial regulatory reform issues is available by contacting any member of the team.

HUD CLARIFIES POSITION ON USE OF LOGO, NAME AND ACRONYM IN ADVERTISING

In recent years, regulators have been focusing more and more on ensuring that lenders do not create an appearance of government affiliation or endorsement with their advertisements. On April 15, 2011, the Department of Housing and Urban Development (HUD) issued Mortgagee Letter 2011-17 to clarify and refine its position on the use of the official logos, names and acronyms of HUD and the Federal Housing Administration (FHA). The requirements set forth in the letter are effective 30 days from the date of the letter. For purposes of this article, "advertisement" means any channel or instrument for soliciting, promoting or advertising FHA products or programs, including material distributed for educational purposes.

FHA-approved mortgagees are permitted to display the official FHA Approved Lending Institution logos on

advertisements to describe to the public the types of loan products offered by the mortgagee, so long as the logo is displayed in a discreet manner and is accompanied, in close proximity to the logo, by a conspicuous disclaimer that the mortgagee is not acting on behalf of or at the direction of HUD/FHA or the federal government. Non-approved mortgagees, including third party originators, may not use the FHA Approved Lending Institution logo in advertisements, and no party may use the FHA logo in its advertisements.

FHA-approved mortgagees may not state or imply that their products or services are coming directly from HUD or FHA. Any advertising device related to FHA programs must be maintained by the mortgagee for a period of at least two years from the date the advertisement is circulated or used.

The Mortgagee Letter requires approved mortgagees to take prompt corrective action upon discovering a violation of the advertising requirements. Penalties for noncompliance may include sanctions, including civil money penalties or administrative action.

Lenders should keep in mind that, in addition to the restrictions set forth under the Mortgagee Letter, Regulation Z and certain state laws also regulate advertising practices that may mislead a consumer to believe a lender is affiliated with or endorsed by a governmental entity. Accordingly, when drafting or reviewing advertisements, lenders must consider and comply with all applicable law.

HACKER ATTACKS ON CORPORATE DATABASES—WHAT EVERY COMPANY NEEDS TO KNOW

Recent high-profile attacks on corporate databases highlight the importance for every company to have readily-available legal and technical plans to address data security breaches in case of the inevitable. As many companies learned over the past few weeks, a breach in a service provider's network can create significant legal obligations and liabilities for them. Liability can attach to a company, through its service provider, regardless of the security of the company's own network.

Patton Boggs' Privacy and Data Security Group prepared a Privacy Client Alert which provides valuable insight on this topic. Further information is available by contacting any member of the team.

CALIFORNIA BANKRUPTCY DECISION FINDS STATUTORY PRE-FORECLOSURE RECORDATION REQUIREMENT FOR MORTGAGES APPLIES EQUALLY TO DEEDS OF TRUST

A recent decision by the U.S. Bankruptcy Court, Southern District of California continued the trend of courts demanding more precision in proving the chain of title for mortgages or deeds of trust being foreclosed (*In re Salazar; U.S. Bank National Association as Trustee v. Eleazar Salazar et al.*). The court ruled that the securitization trustee did not satisfy one of the requirements under California Civil Code § 2932.5 before commencing its non-judicial foreclosure under the deed of trust power of sale. Code § 2932.5 requires that an assignment of a mortgagee's interest (not the beneficial interest of a deed of trust) must be "duly acknowledged and recorded" prior to the secured instrument's foreclosure. In the context of a motion for relief from the automatic stay, the securitization trustee argued that § 2932.5 applied to mortgages only and didn't apply to deeds of trust (which are instead governed by §§ 2924-2924i), citing recent supporting case law specifically on point. The Court disagreed, calling the distinction between mortgages and deeds of trusts "outdated."

MERS was initially the beneficiary under the deed of trust and prior to the foreclosure signed a substitution of trustee (the promissory note had been endorsed in blank) to the securitization trustee. Servicers ran the foreclosure process, and the Trustee's Deed Upon Sale arising from the foreclosure showed the securitization trustee as the foreclosing beneficiary. The Court found that § 2932.5 must "be applied to deeds of trust to ensure trustors are provided the same protection as mortgagors under California law," and that the securitization trustee's assignment should have been "duly acknowledged and recorded." The time for appeal has not yet run.

GINNIE MAE CHANGES SERVICING FEE MARGIN ON HECM MORTGAGE-BACKED SECURITIES

Ginnie Mae has announced that it is changing the servicing fee margin on Home Equity Conversion Mortgage mortgage-backed securities (HMBS). Beginning July 1, 2011, issuers no longer will have the option of a monthly flat servicing fee. Instead, all compensation will be on a basis point strip, with a minimum servicing fee margin of 36 basis points and a maximum margin of 150 basis points.

MARYLAND AMENDS FORECLOSURE PROCEDURES TO REQUIRE AFFIDAVIT AND DISCLOSURE OF LICENSE NUMBERS

Maryland recently passed House Bill 366 amending the provisions regarding a notice of intent to foreclose, order to docket, and complaint to foreclose on a mortgage or deed of trust on residential property. Under the amended statute, which is effective July 2, 2011, an order to docket or complaint to foreclose must include the license number of the mortgage lender and mortgage loan originator, and an affidavit stating: (1) the date on which the default occurred and the nature of default; (2) if applicable, that a notice of intent to foreclose was sent to the mortgagor or guarantor in accordance with the statute and the date on which the notice was sent; and (3) that at the time the notice of intent to foreclose was sent, the contents of the notice were accurate.

DID YOU KNOW?

- **Arizona Permits Conversion of Mortgage Broker License into a Commercial Mortgage Broker License**
  The Arizona legislature recently passed House Bill 2004, which allows for a Mortgage Broker License to be converted into a Commercial Mortgage Broker License. The procedures for such a conversion are not specified and are left to the discretion of the Superintendent of Financial Institutions by rule.
- **Maryland Requires Registration for Exempt Mortgage Lenders Employing Mortgage Loan Originators**
  Effective October 1, 2011, Maryland amended the exemption provisions of the Maryland Mortgage Lender Law. The amended statute requires that entities which are exempt from the mortgage lender license requirement, but that employ licensed mortgage loan originators, register through the Nationwide Mortgage Licensing System (NMLS). Note that the Maryland "Exempt Company Registration" is currently available through the NMLS, but is optional for exempt entities.

LOOKING AHEAD:

October Research
The Future of Mortgage Lending: Evolution or Revolution?
April 19, 2011
2:00 p.m. - 3:30 p.m. EST
Patton Boggs Participant: **Richard Andreano**

Housing Wire's REThink Symposium
"Dodd-Frank and The New Regulatory Regime"
Pinehurst, NC
May 10, 2011
8:45 a.m. - 10:00 a.m. ET
Patton Boggs Participant: **Michael Waldron**

Legal Issues and Regulatory Compliance Conference 2011
Boca Raton, FL
May 15-18, 2011
Patton Boggs Participants: **Richard Andreano** | **Anthony Laura** | **John Socknat** | **Michael Waldron** |**Haydn Richards** | **Heather Hutchings** | **Reid Herlihy** | **Jaynacia Abraham**

Richard Andreano will be participating in two events during the conference. On May 16 from 1:30 p.m. to 2:45 p.m., and May 18th from 8:30 a.m. to 10:15 a.m., he will take part in the "Regulatory Panel 2: New Challenges in Loan Originator Compensation Requirements," and on May 16 from 4:45 p.m. to 5:45 p.m., he will participate in the "Loan Originator Compensation Roundtable." John Socknat will be participating in "Workshop 3: State Law Developments" on May 15 from 2:45 p.m. - 3:45 p.m.

California Land Title Association 104th Annual Convention
The Changing Regulatory Landscape: The New Bureau of Consumer Financial Protection (CFPB) and its impact on Lender and Settlement Agent Practices
Napa, CA
May 23, 2011
9:00 a.m. – 10:00 a.m. PT
Patton Boggs Participant: **Richard Andreano**

National Notary Association 33rd Annual Conference
An Introduction to Dodd-Frank
Las Vegas, NV
May 25, 2011
1:00 - 2:30 p.m.
Patton Boggs Participant: **Heather Hutchings**