

## House Mortgage Reform Bill Offers Major Changes for Lenders, Securitizers, and Others

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On December 11, 2009, the U.S. House of Representatives, led by Financial Services Committee Chairman Barney Frank (D-Mass.), passed the behemoth and wide-sweeping Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173 or Wall Street Act). (See our article, “House Passes Major Financial Services Reform Package,” at [http://www.pepperlaw.com/publications\\_update.aspx?ArticleKey=1673](http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1673)). Less publicized but equally important was the inclusion in the Wall Street Act of important mortgage legislation which would significantly affect mortgage products.

H.R. 4173 was the Mortgage Reform and Anti-Predatory Lending Act (the Bill), which would amend the Truth in Lending Act (TILA) to reform consumer mortgage practices. Title VII was originally passed as part of H.R. 1728, introduced in the House on March 26, 2009, and passed by a vote of 300-114 on May 7, 2009. The House Rules Committee included the Bill as part of H.R. 4173 before consideration of the Wall Street Act began on the House floor.

The Bill reflects Congressional belief that if consumers only had additional written disclosures, the foreclosure crisis would have been avoided. While effective disclosure certainly is in the best interests of creditors and consumers, the Bill could have the opposite effect of creating “information overload” for consumers. If enacted, the Bill would impose minimum mortgage standards, impose certain liability on mortgage securitizers, require creditors to retain certain credit risk for their mortgages, prohibit financial incentives for mortgage originators to steer consumers to less desirable loans, promote consumer counseling programs, and reform appraisal practices. The Bill also contains several new

disclosure requirements regarding loan terms and the lending process.

This article details many of the important provisions of the Bill and how they will affect the mortgage industry. A more detailed listing of the provisions of the Bill is available at [http://www.pepperlaw.com/pdfs/FinServAlert0110\\_TitleVII\\_Table.pdf](http://www.pepperlaw.com/pdfs/FinServAlert0110_TitleVII_Table.pdf).

### SUBPART A – RESIDENTIAL MORTGAGE LOAN ORIGINATION STANDARDS

Subpart A would amend TILA by adding a new Sec. 129B to Chapter 2. The purpose of the amendment is to assure that consumers are offered, and receive, residential mortgage loans on terms that “reasonably reflect” their ability to repay the loans. This subpart requires certain written disclosures, including the comparative costs and benefits of each residential mortgage loan product presented by the originator. In addition, the mortgage originator must: (a) be qualified and, when required, registered and licensed under applicable law, including the Secure and Fair Enforcement for Mortgage Licensing Act of 2008; (b) “diligently work” to provide a consumer seeking information on residential mortgages with a range of loan products for which the consumer would most likely qualify, based on information provided; and (c) make complete and timely disclosure of the nature of the originator’s relationship with the consumer and any conflicts of interest.

Subpart A also would amend Sec. 129B by prohibiting the originator from steering the consumer into a loan that: (a) the consumer lacks a reasonable ability to repay; (b) does not provide a consumer refinancing a residential mortgage loan with a net tangible benefit; or (c) has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms).

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## SUBPART B – MINIMUM STANDARDS FOR MORTGAGES

Subpart B would amend TILA Chapter 2 by adding Sec. 129C, which would establish a minimum federal standard for all home loans: Institutions must ensure that borrowers have the ability to repay their loans. Originators would have to determine, based on verified documentary evidence, that the borrower has a “reasonable ability to repay,” based on income, credit history, indebtedness and other factors.

**Refinancing:** The Bill would prohibit a creditor from refinancing a residential mortgage loan that involves refinancing of a prior existing residential mortgage loan, unless the creditor reasonably and in good faith determined that such refinancing would result in a “net tangible benefit” to the consumer.

**Civil Liability:** The Bill would permit the consumer to bring a civil action against a creditor for violations of the Bill. Under the Bill, a consumer could seek rescission of the loan and any costs incurred because of the violation. Such rescission rights would not be exercisable, however, if the creditor cures the violation within 90 days after receiving notification from the consumer that the loan violates the terms of the section. Additionally, the Bill would provide to a consumer with rescission rights, a defense or counterclaim to foreclosure by a creditor. If a foreclosure proceeding is instituted, and a consumer has a rescission claim available, the consumer would be able to seek actual damages incurred by reason of the violation, including attorney’s fees.

**Liability of Securitizers:** The Bill would impose liability on securitizers for loans that violate the “ability to pay” and “net tangible benefit” standards. Purchasers of loans that do not meet these standards – not the originators – would be liable for rescission of the mortgage contract. In response to this provision, some members of the House Republican Conference have raised concerns that applying liability to mortgage purchasers could add further turmoil to the already devastated secondary market. Some Conference members also said that this legislation will become a boon to trial attorneys, now able to sue for penalties against any owner of a securitized mortgage that was originally sold in a way that violated the Bill. The Bill’s imposition of liability on securitizers also appears to be at odds with the stated goals of President Obama and Treasury Secretary Timothy Geithner. The President has said: “[W]e’re going to have to figure out what we do with the nonbanking sector that was providing almost half of our credit out there. And we’re going to have to determine whether or not as a consequence of some of the steps that the

IF ENACTED, THE BILL WOULD IMPOSE MINIMUM MORTGAGE STANDARDS, IMPOSE CERTAIN LIABILITY ON MORTGAGE SECURITIZERS, REQUIRE CREDITORS TO RETAIN CERTAIN CREDIT RISK FOR THEIR MORTGAGES, PROHIBIT FINANCIAL INCENTIVES FOR MORTGAGE ORIGINATORS TO STEER CONSUMERS TO LESS DESIRABLE LOANS, PROMOTE CONSUMER COUNSELING PROGRAMS, AND REFORM APPRAISAL PRACTICES.

Fed has been taking, the Treasury has been taking, *that we see the market for securitized products restored.*” “After the Great Recession,” *New York Times* (May 3, 2009). Additionally, Geithner has said: “No financial recovery plan will be successful unless it helps restart securitization markets for sound loans made to consumers and businesses – large and small.” Secretary Geithner Introduces Financial Stability Plan, TG-18 (February 10, 2009) (<http://www.treasury.gov/press/releases/tg18.htm>) (last visited October 9, 2009).

**Retained Credit Risk:** The Bill requires the federal banking agencies (the Federal Reserve Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the National Credit Union Administration) to adopt regulations requiring any creditor that makes a residential mortgage loan that is not a qualified mortgage to retain “an economic interest in a material portion of the credit risk” – at least 5 percent – for any loan that the creditor transfers. The agencies would have the authority to provide exceptions or adjustments to this requirement.

## SUBPART C – HIGH-COST MORTGAGES

Subpart C would amend TILA to expand the protections available under federal rules on high-cost loans by lowering the interest rate, points and fee triggers that define high-cost loans. This

subpart contains several prohibitions, including, for example: (a) balloon payments; (b) creditors recommending or encouraging consumers to default on an existing loan or other debt before the closing of a high-cost mortgage that refinances all or part of the existing loan or debt; and (c) modification or deferral fees, unless the modification results in a lower annual percentage rate for the consumer and the amount of the fee is comparable to the fee imposed for similar consumer credit transactions.

**Civil Liability:** A creditor who commits a violation of this subpart may avoid liability where the creditor promptly takes remedial action to correct the violation. The subpart provides specific timeframes during which such remedial action must be taken.

**Regulations:** The Bill directs the Federal Reserve Board to publish final regulations implementing this subpart within six months of the Bill's enactment.

#### SUBPART E – MORTGAGE SERVICING

Subpart E would amend TILA Chapter 2 to provide that a creditor in a consumer credit transaction that is secured by a first lien on the principal dwelling of the consumer must establish an escrow or impound account for the payment of taxes and hazard insurance and, if applicable, flood insurance, mortgage insurance, ground rents and any other required periodic payments.

#### SUBPART F – APPRAISAL ACTIVITIES

Subpart F would amend TILA Chapter 2 to prohibit a creditor from extending credit in the form of a subprime mortgage to a consumer without first obtaining a written property appraisal. This amendment also would provide that unfair or deceptive practices in extending credit or providing services for a consumer credit transaction secured by the consumer's principal dwelling are unlawful. The Bill also would make it unlawful for a certified or licensed appraiser to conduct an appraisal for a property in which the appraiser had a direct or indirect interest.

**Regulations:** The Federal Trade Commission and the federal bank regulatory agencies are required to promulgate regulations within 180 days of enactment of the Bill, and with an effective date of no later than one year from enactment.

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