

The New HOEPA Rule

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Overview



- Broad new rule, adopted principally under the Federal Reserve Board's (the "Board") authority under Section 129 of the Truth in Lending Act ("TILA")
- TILA Section 129(l)(2): "The Board, by regulation or order, shall prohibit acts or practices in connection with—
 - (A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and
 - (B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower."
- This presentation provides a basic overview of the significant parts of the new rule and addresses some of the most interesting issues that have already been identified

Overview

■ The Rule Creates

- A new category of “higher-priced mortgage loans” (“HPMLs”) and sets forth requirements relating to HPMLs
- New rules for all closed-end mortgage loans secured by the principal dwelling, including in relation to both origination and servicing; and
- New advertising rules to curb various practices the Board considers deceptive – new rules for both open- and closed-end mortgage loans

Overview

- Rule and accompanying supplementary materials are over 400 pages long and there are many nuances yet to be discovered.
 - Undoubtedly much will be learned as thousands of lenders and servicers across the country adjust their systems, policies and procedures to comply with the rule.
- Rule transforms TILA as applied to mortgages from principally being a disclosure regime to one with significant substantive restrictions

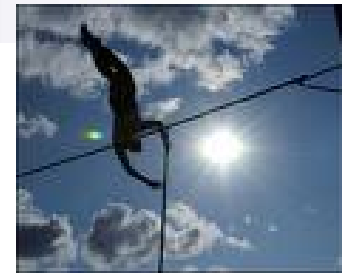
Effective Dates

- General effective date – October 1, 2009
 - Servicing rules effective for both new and existing loans as of that date
 - April 1, 2010 for escrow requirements on site-built homes
 - October 1, 2010 for escrow requirements on manufactured housing loans
- Retroactive effect of rule?

What Did the Board Drop From the Original Proposal?

- The controversial proposal to require a broker agreement that limited the broker fee
 - Comments of members of the Board during the meeting at which this was adopted indicated that the Board is likely to revisit the issue of regulating broker fees under their Section 129 authority
- The requirement that servicers provide a comprehensive servicing fee disclosure

Threshold



- APR of “average prime offer rate” – yet to be fully defined – plus 150/350 basis points for first/subordinate liens
 - Expected to be similar to the Freddie Mac Primary Mortgage Market Survey, but the Board will use the rate and points from the survey to calculate an APR for various loan types
 - Board is seeking comment on the average prime offer rate in the context of its Regulation C proposal – comments due August 29
- Calculated as of time of rate lock – so lenders will need procedures for filling in if the loan is identified as an HPML only at the time of rate lock
- Lenders need to analyze carefully whether FHA, jumbo, and PMI loans end up in the HPML category

Loan Categories

- HPMLs include only closed-end loans secured by the borrower's principal dwelling. This excludes:
 - HELOCs
 - Loans on second homes and investment properties; and
 - Short term construction loans
- Open question: Principal dwelling as of when?
- Unlike HOEPA, HPMLs will include purchase money loans

Ability to Repay

- Loan by loan basis – no “pattern or practice” requirement for a challenge.
- Requires lender to verify the consumer’s repayment ability (e.g., verifying the consumer’s income, assets and current obligations);
- Creates presumption of compliance if lender:
 - Assesses repayment ability “using the largest payment of principal and interest scheduled in the first seven years following consummation and taking into account current obligations;” and
 - Takes into account either the consumer’s debt-to-income ratio, or the income the consumer will have after paying debt obligations.
- Defense if income/assets relied on “not materially greater” than what creditor could have verified at closing

Practical Effect



- If a HPML goes to default or foreclosure, a plaintiff will likely claim that the lender did not comply with the underwriting requirements.
 - Claim could be based on actual personal data that was in the application or otherwise, showing that the borrower could not possibly have paid the loan
 - Claim could be based “on information and belief” if no other basis.
 - Will “information and belief” be enough to beat a motion to dismiss under the *Twombly* pleading standard?

“Presumption of Compliance”

- What does “Presumption” mean?
 - Can be rebutted
 - The presumption should be expected to help a lender win on summary judgment
- Bottom line: potential for substantial litigation of each HPML foreclosure
 - Lenders should plan for high costs litigating even frivolous claims
 - Investors should consider possibility of long foreclosure delays while the issue is being litigated
 - Will courts stay foreclosures while lawsuit is pending?

Requirements on all Closed-End Loans Secured by Borrower's Principal Dwelling

- Appraiser anti-coercion
- Servicing

Appraiser Coercion



- Very broad anti-coercion rule that prohibits not only coercion but also any act that might influence the appraisal or “otherwise encourage” misstatement of value.
- The rule provides
 - examples of acts that are violations (e.g. “[t]elling an appraiser a minimum reported value of a consumer’s principal dwelling that is needed to approve the loan.”); and
 - examples of acts that are not violations (“[a]sking an appraiser to consider additional information about a consumer’s principal dwelling or about comparable properties.”).
- Lender must not extend credit if knows at consummation coercion occurred unless it documents diligence to ensure appraised value not misstated

Appraiser Coercion



- May be hard to defend against claims that the lender knew of appraiser coercion
- Because of section 129 liability, the penalties for claims of influencing the appraiser are very high
- Like “ability to repay” claims, expect appraiser coercion counterclaims in foreclosures
 - What will plaintiffs have to plead to survive motion to dismiss?

Servicing Requirements

- Prompt response to payoff requests
- Application of payments the same day as they are “received.”
 - Will create numerous operational difficulties for payments received other than in the ordinary course.
- No late fee pyramiding.
 - Already illegal – it appears that industry did not even bother to comment on this section.
- Board dropped proposed requirement for a fee schedule.

Other Requirements on HPMLs

- First lien HPMLs must be escrowed for at least the first year
- Strict prepayment penalty restrictions
 - No prepayment penalties for loans where the payment may change in first four years; and
 - Prepayment penalties limited to a two year duration for other loans and may not be imposed in a same creditor refinance
- Anti-evasion provision to prevent creditors from structuring loan as an open end loan to avoid HPML status
 - Back to *Benion v. Bank One* “spurious open-end” litigation

Liability



- Most sections were promulgated under the Board's Section 129 authority. Liability under this provision includes:
 - The usual closed-end TILA liability (statutory damages of \$200-\$2000 capped at \$500,000 for a class action plus attorneys fees)
 - Plus two additional types of liability:
 - Actual damages are potentially available for violations of some of the new requirements
 - Actual damages are and have been available since the inception of TILA in 1968 but have almost never been proven because it is difficult to attribute actual losses to disclosure violations
 - "All finance charges" under section 130(a)(4) for violations of Section 129
 - No explicit class action cap on either of these types of damages

Liability - Statute of Limitations



- Affirmative claims can be made for one year from the date of the violation – typically, loan closing for origination errors; later for servicing errors
- Available in recoupment or set-off until loan payoff
 - The possibility of recovering “all finance charges” in this context could lead to very large amount of money.
 - Similarly, for a servicing violation, the effect of “all finance charges” will be dramatic.

Liability – Lower Liability for Certain Requirements

- Some sections of the advertising rules are adopted under Section 105 authority
- Liability will be less dramatic

Liability – Who is Liable?

- The civil liability sections apply only to “creditors.”
 - The servicing requirements bind “servicers” rather than “creditors” – does a servicer which was not the creditor on the transaction escape civil liability, leaving enforcement to governmental agencies?
 - Does this affect corporate structure?
 - The appraiser coercion rule applies to “mortgage brokers” (as defined) as well as to creditors. Do they also escape civil liability?

Liability – Who Isn't Liable?

- Section 131(d) of TILA provides for assignee liability for a “mortgage referred to in Section 103(aa)”
 - The rule does not change that statutory definition
- The statute does not provide for assignee liability for HPMLs any more than it does for most mortgage loans
 - Assignees only liable for TILA violations that are apparent on the face of the documents

Liability –Motion to Dismiss Standard

- Previously, under *Conley v. Gibson*, dismissal prohibited unless “no set of facts” could be proved in support of the plaintiff’s claim
- Supreme Court’s 2007 decision in *Bell Atlantic Corp. v. Twombly* tightened the standard
 - a plaintiff must allege “enough facts to state a claim to relief that is *plausible* on its face.”
 - “[f]actual allegations must be enough to *raise a right to relief above the speculative level* on the assumption that all the allegations in the complaint are true (even if doubtful in fact).”
- What must plaintiffs allege to state a claim under new HOEPA rule?
 - Will “on information and belief” be enough?

Liability –Retroactive Effect?

- Board takes pains to state that the new rule, and the Board's associated findings that various practices are unfair, do not take effect until the effective date of the rule.
- There is concern that the Board's findings will be misused by plaintiff's attorneys in an attempt to make the case that the practices that are banned by the rule for unfairness were unfair before the rule was promulgated.

Question & Answer

Any further questions may be submitted electronically
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