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Dodd-Frank Financial Services Reform: One Year Later

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What does the current mortgage landscape look like?

- The current housing reform environment consists of :
  - Policy uncertainty
  - Competing initiatives driving reform agenda
  - Origination volume headwinds
  - Lenders and servicers bogged down with existing baggage
  - Lenders and servicers developing parallel process of resolving legacy issues and focusing on future
  - Significant market uncertainty

Regulatory Hot Topics

- Dodd-Frank
  - What can we expect form the CFPB?
  - Pre-emption – what will it mean?
  - Risk retention and Qualified Residential Mortgages (“QRM”)
- Extraordinary focus on mortgage banking activities
  - Game changing reform a given
- Foreclosures, Loss Mitigation and Loan Modifications
  - Interagency horizontal results
  - Substantive correction actions required

What is on the horizon?

- Bureau of Consumer Financial Protection
  - On July 21, 2011, the rulemaking powers for most consumer financial protection laws were consolidated and transferred from separate agencies to the CPFB
- Customer Complaints
  - One of the consent order components and likely one of the CPFB's top areas of focus
  - The CFPB is creating a database to collect, respond to and refer consumer inquiries and complaints about consumer financial products and services
  - The database appears to be comprehensive and designed to be shared with many other government and legal entities
  - In addition to storing all the complaints received, the CFPB will be gathering complaints from all bank and credit union regulators, at the state and federal level

National Servicing Standards

- Fannie Mae and Freddie Mac have published new servicing guidelines under the direction of the FHFA
- The implementation of national servicing standards has recently been discussed by the Senate, the House, the FDIC, and other regulatory agencies
- The FHFA Delinquency management and Default Prevention directives are effective September 1, 2011
  - Borrower Delinquency Management Model: One point of contact
  - Quality Right party Contact: Borrower outreach and communication guidelines
  - Property Inspections: Initial requirements and frequencies
  - Call Center Benchmarks: Inbound call metrics and services levels, email response times
  - Outbound Call Attempts: Call initiation and call campaigns
  - Letters and Notices:
    - Foreclosure Prevention Solicitation Letters
    - Post Referral to Foreclosure Solicitation Letter
    - Borrower Solicitation Package
    - Borrower Response Package
    - Acknowledgment
    - Incomplete Information Notice
    - Evaluation Notices
    - Breach Letter

Consumer Financial Protection Bureau

- In July, the CFPB began to outline the approach it will take in supervising depository institutions with total assets over $10 billion
- Most institutions will be subject periodic examinations; more complex organizations will have year-round teams dedicated to their supervision
- CFPB's examination manual is still in development
- It is unclear how the supervisory process will be applied to other organizations, and likely will take shape after the first director is approved.

Consumer protection laws transferred to the CFPB

- Federal Reserve Board
  - ECOA (Reg. B), HMDA (Reg. C), EFTA (Reg. E), Registration of Mortgage loan originators (Reg. H), Consumer Leasing (Reg. M), Privacy (Reg. P), FCRA (Reg. V), TILA (Reg. Z), TISA (Reg. DD)
- OCC
  - Adjustable Rate Mortgages, Registration of Residential Mortgage Loan Originators, Privacy, FCRA
- HUD
  - Interstate Land Sales Act, RESPA (Reg. X), investigations in Consumer Regulatory Programs
- FDIC
  - Privacy, FCRA, Registration of Mortgage Loan Originators
- FTC
  - Telemarketing Sales Rule, Privacy, Mortgage Assistance Relief Services, Prenotification Negative Option Plans, Sales Cooling-0ff Period, Consumers' Claims and Defenses, Credit Practices, Mail and Telephone Order Merchandise, Franchising, Business Opportunities, FDCPA and exemptions

Dodd-Frank

- Titles IX, X and XIV are of particular interest to Mortgage Bankers
- Title IX includes “risk retention” and “qualified residential mortgages” provisions as well as credit rating agency provisions
- Title X establishes Consumer Financial Protection Bureau (CFPB) and its responsibilities
- Title XIV, Mortgage Reform and Anti-Predatory Lending Act, is replete with provisions affecting the industry including originator compensation, underwriting requirements and qualified mortgage provisions, to name a few.
  - Subtitle A: Originator compensation is substantially revised.
  - Subtitle B: Defines “Qualified Mortgage” standards, prohibits prepayments.
  - Subtitle C: Defines “high-cost mortgage” at 6.5% more than prime, 8.5% for seconds.
  - Subtitle D: Establishes a counseling facility under HUD.
  - Subtitle E: Addresses servicing of mortgages, rules for escrow payments.
  - Subtitle F: Property appraisal requirements.
  - Subtitle G: Mortgage modifications and consumer protections for same.
  - Subtitle H: Reforms of Freddie Mac and Fannie Mae.

Key Dodd-Frank Mortgage Provisions

- The Dodd-Frank Act seeks to reform residential mortgage lending and securitization practices by various mechanisms.
- It provides minimum standards for mortgages that require a lender to determine that a consumer has a "reasonable ability to repay" at the time of origination.
- A lender that issues a "qualified mortgage" is presumed to meet this requirement and receives some protection from certain liabilities.
- The Act identifies nine criteria for defining a qualified mortgage.
- Dodd-Frank also requires loan securitizers to keep "skin in the game" or retain at least 5% of the credit risk of any securitized residential mortgages that are not qualified residential mortgages, i.e., fall within a category of lower default risk.

Mortgage Reform: “more tsunami than simple wave.”

- Mortgage servicing under “severe stress”
- Basel III takes a “highly skeptical view of the value of Mortgage Servicing Rights as bank assets”
- 15-20 new mortgage lending requirements in the regulatory pipeline
- Agency actions against the largest servicers
- There will soon be comprehensive mortgage servicing standards (by year end?)
- The credit risk retention rule will fundamentally change the securitization business
- Fannie Mae and Freddie Mac issued detailed guidelines for mortgage servicing and delinquency management, including financial sanctions for servicers
- Other rulemakings are due within 18 months on ability to repay, restrictions on prepayment penalties, and comprehensive new mortgage disclosure

Qualified Residential Mortgage

- Earlier this year, six federal regulators issued proposed regulations to implement the risk retention rules. The proposal defines QRM loans as those that are "plain vanilla," meeting historically conservative underwriting guidelines such as:
- 30 year maturity or less
- Fixed rate only
- Fees and points of 3% or less (these could include appraisal fees, loan originator compensation, hazard insurance and other items above and beyond the standard closing costs and points)
- Loan to value (LTV) less than or equal to 80% on purchases (or 20% down); 75% for refinances with no cash out; and 70% for cash out refinances
- Borrower's total debt to income (DTI) ratio of less than 36%
- No 30 days past due obligations at time of application; no 60 days past due obligations over the prior two years

Implications and Impacts

- QRM/Risk Retention
  - Sponsor to maintain risk retention unless meeting strict QRM requirements or GSE guaranteed
    - Initial QRM proposal would exclude the majority of loan originations, meaning these loans would continue to be sold to GSE's
    - Risk retention requires greater capital usage and may limit the number of securitizers, thus reducing ultimate competition for loans and servicing
    - Higher capital costs likely to impact forward mortgage rates and origination forecasts
- Dodd-Frank
  - Points/Fees/Premium Pricing limitations
    - When combined with the above, the result is more emphasis on points and fees rather than premiums
      - Likely will impact prepayments and production volumes
    - Will impact any remaining third party originators

Securitization

- The proposed credit risk retention rule mandated under Dodd-Frank extremely controversial
- Comment period expired on August 1, 2011
- Dodd-Frank required regulators to establish a "qualified residential mortgage" category of loans that would be exempt from Dodd-Frank's risk retention requirements
  - The proposal has been widely criticized
- Reg AB II, revisions to the registration, disclosure and reporting requirements for ABS and other structured finance products has been put on hold by the SEC while it focuses on Dodd-Frank rulemaking deadlines.

GAO Study on Impact of Dodd-Frank Act on Mortgage Market

- The Dodd-Frank Act required the GAO to assess the potential impact of the mortgage provisions
- The GAO examined mortgages originated between 2001 and 2010
  - Mortgages were examined to determine whether they met five of the nine qualified mortgage criteria
    - Payment of loan principal, length of mortgage term, scheduled lump-sum payments, documentation of borrower resources, and borrower debt burden
  - There was insufficient data to examine the other four criteria
- The GAO found that most mortgages would have met the five qualified mortgage criteria
- The review of securitization noted that key regulatory decisions remained outstanding
- The GAO concluded that undecided factors, such as which mortgages are exempted from risk retention, the forms of risk retention and amount required, could affect the availability and cost of mortgage credit and the viability of a private mortgage securitization market

Unintended Consequences?

- Will lenders make, buy or securitize non-QM or non-QRM loans?
- Does the QRM definition requiring "underwriting and product features that historical loan performance data indicate result in a lower risk of default" effectively eliminate any possibility of the development of new mortgage products?
- Fair Lending implications
- CRA implications
- Tension between balance sheet and liquidity
  - Retention of 5% economic interest
  - Regulators allowed to allocate retained risk between securitizers and originators
- Does this matter in a market that is 99% government backed?
- Can a private securitization market be developed with the increased risks?

Thank you!

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