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To the Point!

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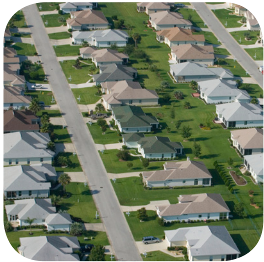

Mortgage Rules Update

Prepayment Penalties and the Revised HOEPA Rule

The Dodd-Frank Act revised and expanded the tests for coverage under the Home Ownership and Equity Protections Act of 1994 (*"HOEPA"*). Purchase money mortgages and HELOCs are now subject to coverage under the HOEPA rule, and the coverage tests for all other loans have changed. If a mortgage loan meets any of the rate-based, fee-based, or prepayment penalty-based determinations the loan is now a high-cost loan subject to HOEPA. The prepayment penalty test is new and, as a result, any loan with a prepayment penalty must be reviewed carefully to determine whether the loan meets the high-cost definition. A loan is a high-cost loan if:

1. *Rate-based Test.* The APR (measured as of the date the interest rate for the transaction is set) exceeds the Average Prime Offer Rate (APOR) for a comparable transaction on that date by more than:

- 6.5 percentage points for first-lien transactions, generally, or
- 8.5 percentage points for first-lien transactions that are for less than $50,000 and secured by personal property (*e.g.*, RVs, houseboats, and manufactured homes titled as personal property), or
- 8.5 percentage points for junior-lien transactions.

2. *Fee-based Test.* The points and fees exceed the following thresholds:

- 5 percent of the total loan amount for a loan amount greater than or equal to $20,000, or
- 8 percent of the total loan amount or $1,000 (whichever is less) for a loan amount less than $20,000.

3. *Prepayment Penalty-based Test.* The lender charges a prepayment penalty:

- more than 36 months after consummation or account opening, or
- in an amount more than 2 percent of the amount prepaid.

For a closed-end loan, a prepayment penalty means a charge imposed for paying all or part of the loan's principal before the date on which the principal is due. For a HELOC, a prepayment penalty means a charge imposed if the consumer terminates the HELOC prior to the end of its term, including a cancellation fee. If the prepayment penalty exceeds 2 percent of the amount prepaid for a closed end loan or 2 percent of the initial credit limit for a HELOC, the loan is a high-cost loan subject to the HOEPA requirements and restrictions.

Note that if the lender imposes a charge on the borrower to recover *bona fide* third-party fees paid on a borrower's behalf because the borrower prepays the closed-end loan or terminates the HELOC sooner than 36 months after origination, such charge is not a prepayment penalty restricted under the rule.

Prepayment penalties are prohibited under HOEPA; thus, mortgage loans are limited to the maximum prepayment penalty of 2 percent of the amount prepaid and the prepayment penalty is limited to the first 36 months following consummation. While lenders are generally familiar with the rate-based and fee-based determination of a high-cost loan, we suggest that lenders take steps to ensure that they include the prepayment

penalty-based determination in their identification of loans subject to the HOEPA requirements and restrictions. Lenders imposing a cancellation fee should check such fees against the HOEPA prepayment penalties restrictions to ensure that such fees have not unwittingly caused the loan to become subject to HOEPA.

CFPB Supervision and Examination Manual

The CFPB updated its guidance on mortgage origination and servicing examinations to incorporate recent revisions to the mortgage rules. In publishing this examination guidance the CFPB declared the guidance as an "initial key step" in implementing its non bank supervision program. In spite of this assertion, the guidelines apply to both bank and non bank entities engaged in mortgage origination and servicing, and both should become familiar with the examination procedures.

The origination examination procedures address the broad range of origination activities from advertisements and marketing practices through loan closing. The servicing examination procedures organize servicing activities into the following topics: "routine servicing," including servicing transfers, payment processing, consumer inquiries and error resolution and maintenance of escrow accounts and insurance products; "default servicing," including collections, accounts in bankruptcy, loss mitigation, and early intervention; and "foreclosure."

The CFPB described its supervision activities, which are applicable to bank and non bank entities, as including reports from supervised entities and conducting examinations. The examination process was further defined as an ongoing process of pre-examination scoping and review of information, data analysis, onsite examinations, and regular communication with and monitoring of supervised entities. The CFPB noted that its examiners will work closely with enforcement staff to address harm to consumers if any such harm is identified in the examination process.

FFIEC Issues Final Guidance On Social Media

On December 11, 2013, the Federal Financial Institutions Examination Council (*"FFIEC"*) issued final supervisory guidance, "*Social Media: Consumer Compliance Risk Management Guidance*" (the *"Guidance"*), to address the applicability of existing federal consumer protection and compliance laws to social media activities of banks and other financial institutions, as well as certain non bank entities supervised by the CFPB (collectively, *"Financial Institutions"*). In the Guidance, the FFIEC reiterated the requirement for Financial Institutions to have a risk management program that identifies, measures, monitors, and controls the risks related to social media. The Guidance provides considerations for Financial Institutions in conducting their risk assessments and putting in place policies and procedures regarding social media.

Although the FFIEC indicated that it adopted the final Guidance substantially as proposed on January 22, 2013 (the *"Proposed Guidance"*), we have identified several significant differences between the Proposed Guidance and the Guidance, including additional clarifications and explanations related to the following topics:

Social Media Definition. The Guidance provides further insight into its intended scope. That is, for purposes of the Guidance, stand-alone messages sent through traditional email and text messages are not considered social media. Only messages sent through social media channels are considered social media for purposes of the Guidance. As noted in both the Proposed Guidance and the Guidance, and as distinguished from other online media by its interactive nature, examples of applicable social media include micro-blogging sites (*e.g.*, Facebook, Google Plus, MySpace, and Twitter); forums, blogs, customer review web sites and bulletin boards (*e.g.*, Yelp); photo and video sites (*e.g.*, Flickr and YouTube); sites that enable professional networking (*e.g.*, LinkedIn); virtual worlds (*e.g.*, Second Life); and social games (*e.g.*, FarmVille and CityVille).

Broader Internet Communication. The Guidance provides that a Financial Institution should evaluate the results of its own risk assessments to determine an appropriate approach for monitoring and responding to Internet communications. One possible approach, discussed extensively in the Guidance, is for a Financial Institution to

establish one or more specific channels that consumers must use to submit a complaint or dispute directly to the Financial Institution for further investigation.
Specifically, under the Community Reinvestment Act, a Financial Institution is not deemed to have received comments made on the Internet through sites that the Financial Institution does not support. As a result, these comments would not need to be monitored or retained. Rather, Financial Institutions should retain comments and responses made on sites supported by the Financial Institution that specifically relate to its performance in helping to meet community credit needs.

Vendor Management. With respect to third parties that provide social media services, a Financial Institution should conduct an evaluation and perform due diligence that is appropriate to the risks posed by the vendor prior to engaging such vendor. The Financial Institution should be aware of the vendor's reputation, the vendor's policies (specifically policies related to collection and handling of consumer information), the vendor's process for changing its policies, and the Financial Institution's control over the vendor's policies or actions. Additionally, a Financial Institution should regularly monitor the information it places on social media websites, even if such placement is made by a third party or on a social media site that is owned and maintained by a third party.

Employee Use. The Guidance also makes clear that Financial Institutions are not required to adopt any particular approach regarding employees' personal use of social media. Instead, the Guidance is focused on employees using social media to communicate officially on behalf of a Financial Institution. Financial Institutions should provide training and guidance to employees regarding such official use of social media.

The Guidance emphasizes that Financial Institutions are responsible for remaining aware of developments in laws and regulations relating to social media. Additionally, in all aspects of the Guidance, the FFIEC has included a caveat that the laws and regulations discussed in the Guidance do not necessarily represent the entirety of the laws and regulations that may apply to the use of email and text messages.

The Guidance remains substantially the same as the Proposed Guidance from January 2013. We continue to recommend that each Financial Institution assess all facets of its use of social media and related risk profile and review and revise its risk management program to ensure that social media is included and properly addressed, even if the Financial Institution does not actively participate in social media interaction with its customers or potential customers.

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