



Summary of Merkley Amendment #3962 to S. 3217 and Comparison to H.R. 4173 Provisions on Originator Compensation and Underwriting Requirements

Merkley Amendment to S. 3217 (Restoring American Financial Stability Act)

Background - The Senate passed an amendment sponsored by Senator Jeff Merkley (D-OR) to the regulatory reform package, S. 3217, the Restoring American Financial Stability Act of 2010. The amendment prohibits direct and indirect compensation (including YSPs and overages) to mortgage originators based on the terms of a loan, including its rate, and establishes new minimum underwriting standards for residential mortgage loans. The amendment appeared late Tuesday evening, May 11, 2010, and was passed by a 63-36 vote first thing Wednesday, May 12, 2010, despite industry concerns.

Loan Originator Compensation - While prohibiting compensation to loan originators based on the terms of a loan, the amendment would allow:

- Compensation to an originator based on the principal amount of the loan.
- Compensation to an originator, other than compensation based on the terms of the loan, to be financed through the loan's rate as long as the originator does not receive any other compensation from the consumer (or anyone else) other than the compensation financed through the rate. Compensation to the originator through the rate would not be permitted if there is also upfront payment of discount points, or origination points, or fees however denominated, other than third party settlement charges.
- Compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser, i.e. compensation to a lender from the secondary market for the sale of a consummated loan.
- Incentive payments to a loan originator based on the number of loans originated within a specified period of time.

Underwriting Requirements - Additionally, the amendment adds provisions to the Home Ownership and Equity Protection Act (HOEPA) provisions of the Truth in Lending Act (TILA) to prohibit lenders from making residential mortgages unless they determine that the borrower has a reasonable ability to repay the loan and all applicable, taxes, insurance and assessments. The amendment spells out what is to be considered by the lender so there is a presumption of compliance with the requirements. The presumption is not available for loans with balloon payments, negative amortization loans and interest-only loans.

There is no presumption of compliance where the total points and fees (defined under TILA) payable in connection with the loan exceed three percent of the loan amount. For purposes of computing the three percent, the points and fees for mortgage guarantee insurance under a state or federal program in excess of one percent of the loan amount are excluded.

MBA Concerns - MBA is extremely concerned that the YSP provisions will markedly lessen the range of mortgage financing options available to consumers. Moreover, the new underwriting provisions will markedly tighten credit so that only the lowest risk borrowers will qualify, and they will increase the rate and costs to consumers of mortgage loans.

The provisions regarding government-insured loans will make it difficult to economically originate government loans and even more difficult to originate other loans. Fees will be included in interest rates and rates and monthly payments will increase. Liability risks for lenders will increase markedly.

Inasmuch as the amendments regarding underwriting are made to HOEPA and TILA and these laws become the responsibility of the new consumer financial protection regulator under other provisions of the S. 3217, the implementing rules for the underwriting provisions, including for government loans, will be the responsibility of the new consumer financial protection regulator. The prudential banking agencies and those agencies responsible for government loan programs should be the ones responsible for these regulations.

Related Provisions in H.R. 4173 (Wall Street Reform & Consumer Protection Act)

Background – H.R. 4173, passed by the House of Representatives late last year, is similar to the Senate bill as amended by Merkely in that it also would prohibit compensation (YSPs and overages) to mortgage originators based on the rate or other terms of a loan (other than the amount of the principal). It would not allow financing origination fees on not qualified mortgages. However, the House bill offers a better, more flexible approach to underwriting requirements. The House bill creates a set of well underwritten “qualified mortgages” that would operate in a safe harbor and have a rebuttable presumption of compliance with the ability to repay and net tangible benefit requirements. Regulations would be developed by the “banking agencies” – the Federal Reserve, the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation and the National Credit Union Administration – and coordinated through the Financial Institutions Examination Council in consultation with the Chairman of the State Liaison Committee.

Loan Originator Compensation - As indicated, the bill prohibits compensation (YSPs and overages) to mortgage originators based on the terms of a loan. The House bill also would not allow a mortgage originator to arrange for a consumer to finance through rate any origination fee or costs except bona fide third party settlement charges not retained by the creditor or mortgage originator except where the mortgage is a “qualified mortgage” (see below) and the originator does not receive any other compensation from the consumer.

The House bill makes clear that it should not be construed as:

- Permitting any YSP or similar compensation that varies based on the terms of the loan other than the amount of the principal;
- Affecting the mechanism for providing the total amount of direct and indirect compensation permitted to a mortgage originator;
- Limiting or affecting the amount of compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser, i.e. compensation to a lender from the secondary market for the sale of a consummated loan;
- Restricting a consumer's ability to finance at the option of the consumer, including through principal or rate, any origination fees or costs permitted under the bill so long as such fees were limited by agreement with the consumer earlier in the process and do not vary based on rate or terms; and
- Prohibiting incentive payments to a mortgage originator based on the number of residential mortgage loans originated within a specified period of time.

Additional Requirements - The House bill also assigns to federal banking agencies responsibility for prescribing regulations to prohibit:

- Steering any consumer to a residential mortgage loan that the consumer lacks an ability to repay;
- Refinancings that do not provide the consumer a net tangible benefit;
- Predatory loan characteristics;
- Steering consumers from a qualified mortgage to a not qualified mortgage;
- Abusive or unfair lending practices that promote disparities among consumers of equal creditworthiness but different races, ethnicity, gender or age;
- Mortgage originators from assessing excessive points and fees as described under 103 (aa)(4) under TILA based on consumer's decision to finance all or part of fees in rate;
- Mischaracterizing a consumer's credit history;
- Mischaracterizing or suborning the mischaracterization of a property's appraised value; and
- Discouraging a consumer from seeking a mortgage loan from another originator, if originator is unable to suggest, offer or recommend to a consumer a loan that is not more expensive than a loan for which the consumer qualifies.

Underwriting Requirements – The House bill establishes:

- Federal banking agencies, in consultation with the Federal Trade Commission, are to prescribe regulations requiring a reasonable and good faith determination based on verified and documented information at time loan is consummated and regulations requiring that no creditor may extend a refinancing without determining at time of consummation that the refinanced loan will provide a net tangible benefit to the consumer.
- A safe harbor for "qualified mortgages" with a presumption that such mortgages meet the ability to repay and net tangible benefit standards.
- Requirements for "qualified mortgages" including that a first mortgage be less than 1.5 percentage points over the Average Prime Offer Rate, 2.5 percentage points for jumbo loans, 3.5 points for subordinate liens.

- That the total points and fees for qualified mortgages not exceed two percent of the total loan amount and other requirements including that the loan not defer principal or interest, require balloon payments and have no more than a 30-year term.
- Notably, Federal banking agencies may revise, add to, or subtract from the criteria that define a “qualified mortgage.”
- Agencies including HUD, Veterans Affairs, Department of Agriculture and the Federal Housing Finance Agency (for Fannie Mae and Freddie Mac) to define qualified mortgages under their respective programs as long as their rules are consistent with the Reform Act.

MBA Concerns - MBA remains concerned that, under the House bill as well, the YSP provisions will markedly lessen the range of mortgage financing options available to consumers. We believe the underwriting provisions, while too restrictive as they stand, at least may be modified by the Federal Banking Agencies and program regulators under the House approach. Finally, in order to ensure affordable lending to more than the least risky borrowers, the safe harbor should be clear and the standards for qualified mortgages made much more reasonable, using the House bill’s approach.