The Loan Originator Rule

Seller Financing & Private Lending after Dodd-Frank

Presented by:
LEGAL EDUCATION DEPARTMENT
of
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The Loan Originator Rule:

Seller Financing & Private Lending after Dodd-Frank

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The Loan Originator Rule

- Put into effect by CFPB to implement Dodd-Frank Requirements
- Comprises amendments to 12 CFR § 1026. of Truth in Lending (Reg Z)
- Prohibitions on mandatory arbitration and financing single-premium credit insurance effective as of **June 1, 2013**
- All other provisions in effect as of **January 10, 2014**
- NOTE: The rule is <u>not an insuring issue for title policies</u>. Lenders are not covered against loss due to their own violations of federal law

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What loans are affected?

- Closed-end consumer loans secured by a dwelling or real property that includes a dwelling
- Does not apply to open-end home equity lines of credit (HELOCs) or time-share transactions
- Does not apply to loans secured by real property if the property does not include a dwelling
- Does not apply to loans for primarily business, commercial or agricultural purposes
- Does not apply to extensions of credit to other than natural persons, including government agencies or instrumentalities

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Loan Originator Rule Highlights

- Prohibits a loan originator's compensation from being based on the terms of a transaction (with limited exceptions) or a proxy for a transaction term
- Prohibits loan originators in a transaction from being compensated by both a consumer and another person, such as a creditor
- Permits contributions to and benefits under designated tax-advantaged plans and certain bonuses and other compensation under non-deferred profits-based compensation plans based on mortgage-related business profits

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Loan Originator Rule Highlights

Qualifications

- Requires loan originators to be licensed and registered if required under state or federal law and requires the organizations that hire them to ensure they are licensed or registered
- Requires companies that hire loan originators to make sure that their loan originator employees who are not required to be licensed and are not licensed meet certain character and fitness standards, pass a criminal background check and are appropriately trained

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Loan Originator Rule Highlights

- Requires certain loan originator identification information to be included on loan documents
- Polices and procedures to comply
- Requires depository institutions to establish and maintain written policies and procedures to monitor compliance with various new and existing rules applicable to their loan originator employees

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Loan Originator Rule Highlights

Restricts mandatory arbitration and waiver of federal claims

- Restricts creditors from including in their contracts mandatory arbitration clauses and provisions where consumers would waive federal statutory causes of action

Financing credit insurance

- Restricts creditors from financing certain credit insurance premiums or fees (single premium)

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What Has Changed?

- Reg Z has long exempted lenders engaging in no more than five consumer mortgages in the preceding calendar year (exception for high-cost loans) under 12 CFR § 1026.2(a)(17) from status as "creditors," freeing them from most requirements

- Sec 494, FL Statutes licensure requirements, embodying the requirements of the SAFE Mortgage Licensing Act of 2008, defines "loan originators" as those who take or negotiate terms of a residential mortgage and mortgage lenders, but excepts seller financing and those not holding themselves out to the public as such or using their own funds 494, FS, § 494.00115 (2)(b) and (e)

- But Reg Z's Loan Originator Compensation Rule defines loan originators more broadly, appearing to pull in "mom and pop" and small private lenders

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Who's a Loan Originator Now?

12 CFR 1026.36 (a)(1)(i):

"For purposes of this section, the term "loan originator" means a person who, in expectation of direct or indirect compensation or other monetary gain or for direct or indirect compensation or other monetary gain, performs any of the following activities: takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person …"

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Who's a Loan Originator Now? (cont'd)

12 CFR 1026.36 (a)(1)(i):

- … or through advertising or other means of communication represents to the public that such person can or will perform any of these activities The term "loan originator" includes an employee, agent, or contractor of the creditor or loan originator organization if the employee, agent, or contractor meets this definition
- The term "loan originator" includes a creditor that engages in loan origination activities if the creditor does not finance the transaction at consummation out of the creditor's own resources, including by drawing on a bona fide warehouse line of credit or out of deposits held by the creditor All creditors that engage in any of the foregoing loan origination activities are loan originators for purposes of paragraphs (f) and (g) of this section
  - (f) and (g) require licensure per applicable law & lender ID on docs)

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What is the Significance?

- Small lenders engaging in no more than 5 consumer mortgages per year were often exempt from definition as "creditors" subject to the full panoply of Reg Z requirements
- CFPB has brought a subset of small lenders under new regulation by defining "loan originators" to include very small lenders
- Therefore, some previously common types of seller/private lender financing may now be . . .

. . . more challenging

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Who's Not a Loan Originator?

12 CFR § 1026.36(a)(1)(i)(A):

- A person who performs purely administrative or clerical tasks on behalf of a loan originator or creditor, but does not take consumer credit applications or offer or negotiate credit terms available from a creditor to that consumer selected based on the consumer's financial characteristics (§ 1026.36(a)(1)(i)(A), Comment 36(a)-4))
- A loan originator's or creditor's employee who provides a credit application to the consumer for the consumer to complete is not an loan originator
- A loan originator's or creditor's employee who delivers the consumer's credit application to the loan originator or creditor is not a loan originator - as long as the employee did not assist the consumer in completing the application, process or analyze information, or discuss particular credit terms that are or may be available from a creditor or a loan originator to that consumer selected based on the consumer's financial characteristics

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Who's Not a Loan Originator? (cont'd)

12 CFR 1026.36 (a)(1)(i)(A):

- A properly licensed real estate broker who performs only real estate brokerage activities so long as you are not compensated by a loan originator or creditor
- A servicer or a servicer's employee, unless you perform loan origination activities on replacing an existing obligation with a new debt as discussed below (See § 1026.36(a)(1)(i)(E))
- An employee of a manufactured home retailer and you do not take applications, offer or negotiate credit terms, or advise consumers on credit terms
- A seller financer who meets certain requirements

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Seller Financing Exclusions

One Property Exclusion
§ 1026.36(a)(4)

The lender must

- Be a **natural person, estate, or trust** and provide seller financing for only one property in any 12-month period
- Own the property securing the financing
- Have not constructed, or act as a contractor for the construction of, a residence on the property in your ordinary course of business

The financing must

- **Have a repayment schedule that does not result in negative amortization** (when the principal balance of the loan may increase due to the addition of accrued interest to the principal balance)
- Have a fixed rate or an adjustable rate that resets after five or more years These rate adjustments may be subject to reasonable annual and lifetime limits

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Seller Financing Exclusions

Three Property Exclusion
§ 1026.36(a)(5)

The lender must

- **Be any type of seller financing entity financing sales of 3 or fewer properties in any 12-month period**
- Have owned the property securing the financing
- Not have constructed, or acted as a contractor for the construction of, a residence in the ordinary course of business

The financing must

- **Be fully amortizing**
- **Be financing the lender has determined in good faith the consumer has a reasonable ability to repay**
- Have a fixed rate or an adjustable rate that resets after five or more years These rate adjustments may be subject to reasonable annual and lifetime limits

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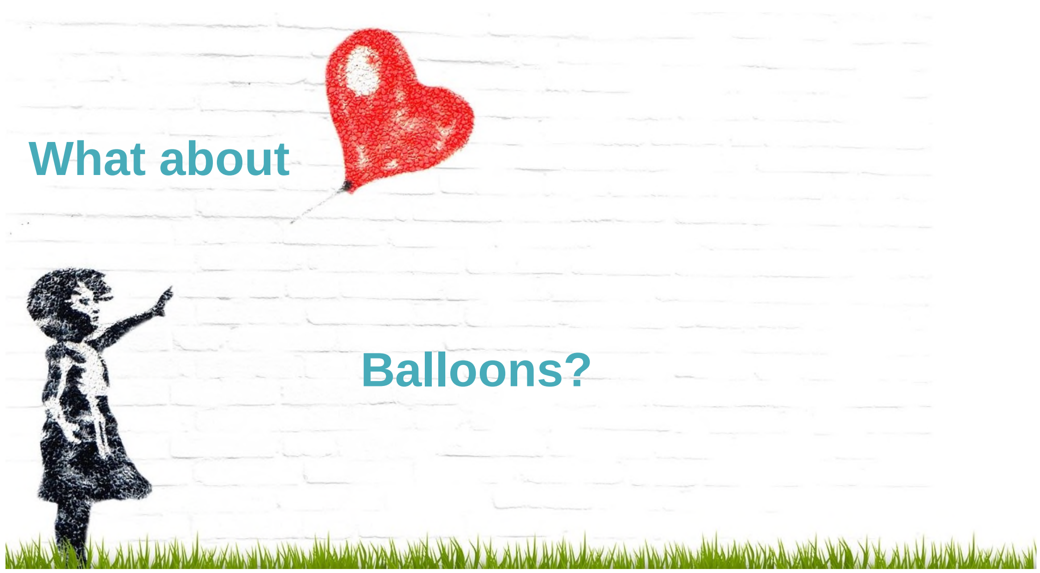

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One-Property vs Three-Property Exclusions

Informally, CFPB attorneys have said:

One-Property Exclusion:

- Under the one-property exclusion only, balloon mortgages are permitted
  - No minimum term before balloon matures
- Under the one-property exclusion only, the note can be interest-only

Three-Property Exclusion:

- Business entities can be the lender
- Balloons and interest-only <u>not</u> permitted
- Lender must have a good-faith belief in borrower's reasonable ability to repay

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How does a lender determine "a reasonable ability to repay?"

Two options:

First option

- Use criteria under § 1026.43(c) (otherwise applicable to "creditors,") which requires consideration of:
  - Consumer's current or reasonably expected income or assets, **other than the value of the dwelling**, including any real property attached, that secures the loan;
  - Consumer's current employment status, monthly payment, credit history, other obligations, etc.
  - (See Rule for complete list)

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How does a lender determine “a reasonable ability to repay?” (cont’d)

Second option

The comment to § 1026.36(a) says in the alternative, lenders can look at:

- Evidence of the consumer’s current or reasonably expected income / earnings
- Income from sources such as a Federal, State, or local government agency
- Income earned from assets,
- Loan originators may rely on IRS Form W-2s or similar IRS forms used for reporting wages or tax withholding, or military Leave and Earnings Statements

However, the **value of the dwelling that secures the financing does not constitute evidence** of the consumer’s ability to repay

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What’s a “reasonable rate adjustment?”

For both special exclusions, where adjustable rate financing is used, an annual rate increase of:

- Two percentage points or less, and
- A lifetime limitation of an increase of six percentage points or less, are deemed reasonable (Comments 1026.36 (a)(4) -2 and 1026.36 (a)(5) -1)
- Further, the index you use must be widely available, such as the US Treasury securities indices or LIBOR*

*LIBOR to be phased out end of 2021

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Warning: One “High-cost” Loan = “Creditor” Status

12 CFR § 1026.32

Just one high-cost loan per year make a lender a “creditor,” under Reg Z, subject to the Home Ownership and Equity Protection Act (“HOEPA”)

- A loan is a “high cost loan” based on
  - Annual percentage rates
    - ex) 6.5 points above average prime offers on a first lien
  - Transaction points and fees
    - ex) 5% of a loan over $20,000
  - Prepayment penalties
    - ex) more than 36 months after closing

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FR/Bar Rider “C” Incorporates Seller Exclusions

C. SELLER FINANCING
(PURCHASE MONEY MORTGAGE; SECURITY AGREEMENT TO SELLER)

WARNING – PRIOR TO ENTERING INTO THE FINANCING CONTEMPLATED BELOW, SELLER AND BUYER ARE ADVISED TO SEEK THE ADVICE OF LEGAL COUNSEL TO DETERMINE IF THIS FINANCING COMPLIES WITH THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (DODD- FRANK) AND OTHER RELEVANT FEDERAL AND STATE REQUIREMENTS.

I. SUMMARY OF SELLER FINANCING UNDER DODD-FRANK – PLEASE READ CAREFULLY

Dodd-Frank has made significant and important changes affecting seller financing on residential properties. Effective January 10, 2014, a seller of residential dwelling(s) who finances buyer's purchase of seller's residential property may be considered a "loan originator" under Dodd-Frank, and required to comply with certain Truth In Lending Act ("TILA") rules and disclosures, unless the seller is entitled to one of the two exclusions set forth in Dodd-Frank:

1. *The "one property exclusion" where seller finances only* ***ONE*** *property in any 12 month period, and:*
   (a) *The seller owns the property and is a natural person, a trust or an estate; and*
   (b) *The seller did not construct or act as the contractor for the construction of a residence on the property in the ordinary course of business; and*
   (c) *The financing does not result in negative amortization; and*
   (d) *The financing has a fixed rate or an adjustable rate that does not adjust for the first 5 years and is subject to reasonable annual and lifetime rate adjustment limits.*

OR

2. *The "three property exclusion" where seller finances no more than* ***THREE*** *properties in any 12 month period, and:*
   (a) *The seller owns the property and is a natural person or organization (corporation, LLC, partnership, trust, estate, association, etc.); and*
   (b) *The seller did not construct or act as the contractor for the construction of a residence on the property in the ordinary course of business; and*
   (c) *The loan is fully amortized, specifically there is no balloon payment or negative amortization; and*
   (d) *The financing has a fixed rate or an adjustable rate that does not adjust for the first 5 years and is subject to reasonable annual and lifetime rate adjustment limits; and*
   (e) *The seller determines in good faith that the buyer/borrower has the reasonable ability to repay the loan.*

A seller who finances the buyer's purchase of seller's residential property and who meets either of the two exclusions outlined above may use this Seller Financing Rider.

A seller who finances the buyer's purchase of seller's residential property and who is not exempt from Dodd-Frank should seek the advice of legal counsel regarding use of this Seller Financing Rider, including modifications or disclosures that may be required by Dodd-Frank, prior to completing this Rider.

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What other guidance has CFPB provided?

Pre-rule loans

Question:
If a mortgage was executed before 1-10-2014, and modified after that date, must the note and mortgage be modified per the new rules?

Answer:
It depends If the mod were significant enough to term it a new loan under state law, then the new rules would have to be followed; otherwise no

Accordingly, it appears that a mere modification to a pre- 1-10-2014 loan need not comply with the new rules, while a novation would have to comply

WARNING: These "informal" answers derive from reports of e-mail and telephone conversations with CFPB lawyers, and may be subject to nuance or change. Please contact CFPB directly for critical decisions or advice

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The Burning Question Still Unanswered

Question:
If an occasional lender "makes an extension of consumer credit for another person" but only receives "compensation" in the form of a reasonable rate of interest, is that person a "loan originator" for purposes of the rule?

Answer:
CFPB has reportedly said various things, but has committed nothing to writing to let small lenders off the hook

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CFPB Penalties Are Significant

TRID violations of any kind can result in fines of:

- $5,000 per day per violation
- $25,000 per day for **reckless** violations
- $1 million per day for **knowing** violations
- Increased based on inflation

For violations of federal consumer financial laws or rules, courts or CFPB may also grant:

- Rescission or reformation of contracts;
- Refund of monies or return of real property;
- Disgorgement or compensation for unjust enrichment;
- Payment of damages or other monetary relief;
- "And other relief"

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What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.25(c)(2) Record Keeping

If you are a creditor that is not a loan originator organization for purposes of the compensation provisions, you must maintain records for 3 years sufficient to evidence:

- All compensation you pay to loan originators
- The compensation agreements that govern those payments or entities
- All compensation you receive from creditors, consumers, and other individuals
- All compensation you pay to individual loan originators
- The compensation agreements that govern those receipts or payments

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What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(d)(1)(i) Compensation

- No compensation in an amount that is based on a term of a transaction, the terms of multiple transactions by an individual loan originator, or the terms of multiple transactions by multiple individual loan originators
- No compensation, from any person other than the consumer in connection with the transaction; and
- No compensation from any person who knows or has reason to know of the consumer-paid compensation to the loan originator

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What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(e) Prohibition on steering (excerpts):

1 General
In connection with a consumer credit transaction secured by a dwelling, a loan originator shall not direct or "steer" a consumer to consummate a transaction based on the fact that the originator will receive greater compensation from the creditor in that transaction than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer interest

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What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(e) Prohibition on steering
(excerpts):

2 PERMISSIBLE TRANSACTIONS
A transaction does not violate paragraph (e)(1) of this section if the consumer is presented with loan options that meet the conditions in paragraph (e)(3) of this section for each **type of transaction** in which the consumer expressed an interest For purposes of paragraph (e) of this section, the term "type of transaction" refers to whether:

- A loan has an annual percentage rate that cannot increase after consummation;
- A loan has an annual percentage rate that may increase after consummation; or
- A loan is a reverse mortgage

What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(e) Prohibition on steering
(excerpts):

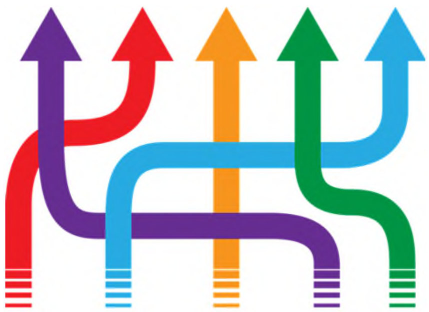
(3)(i)
The loan originator must obtain loan options from a significant number of the creditors with which the originator regularly does business and, for each type of transaction in which the consumer expressed an interest, must present the consumer with loan options that include:

A. The loan with the lowest interest rate;
B. The loan with the lowest interest rate without negative amortization, a prepayment penalty, interest-only payments, a balloon (…)(etc.) and
C. The loan with the lowest total dollar amount of discount points, origination points (…)(etc.)

What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(e)(4)

NUMBER OF LOAN OPTIONS PRESENTED
The loan originator can present fewer than three loans and satisfy paragraphs (e)(2) and (e)(3)(i) of this section if the loan(s) presented to the consumer satisfy the criteria of the options in paragraph (e)(3)(i) of this section and the provisions of paragraph (e)(3) of this section are otherwise met.



What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(f)

Comply with state law licensing requirements

See Sec. 494, FS

Recall exceptions for lenders
- Not holding themselves out as lenders, or
- Using their own money

What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(g) Information required to be included on documents

Your name and National Mortgage Licensing System & Registry ID, if the NMLSR has provided you an NMLSR ID

The name of the individual loan originator (as the name appears in the NMLSR) with primary responsibility for the origination and his NMLSR ID, if he has one

Required on

- Credit application
- Note or loan contract
- Security instrument

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What would it take for a private lender to comply with the Loan Originator Rule?

§ 1026.36(h) (all consumer credit secured by a dwelling)
Prohibits
- Mandatory arbitration and
- Waiver of federal claims

§ 1026.36(i)
Prohibits
- Financing certain credit insurance premiums or fees (single premium)

§ 1026.36(k)
Requires
- First-time borrowers must receive counseling from a certified counseling organization when a creditor offers a negative-amortization loan

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What can private lenders who don't qualify for the exclusions still do?

- Make loans not secured by a dwelling or property including a dwelling
- Make open-end home equity lines of credit (subject to some provisions of the rule) or time-share transactions
- Make loans for primarily business, commercial or agricultural purposes
- Make extensions of credit to other than natural persons, including government agencies or instrumentalities
- Make loans to family members or others with no expectation of monetary gain
- Comply with the rule (which should be simpler for small lenders)
- Work with a licensed, Reg Z - compliant loan originator

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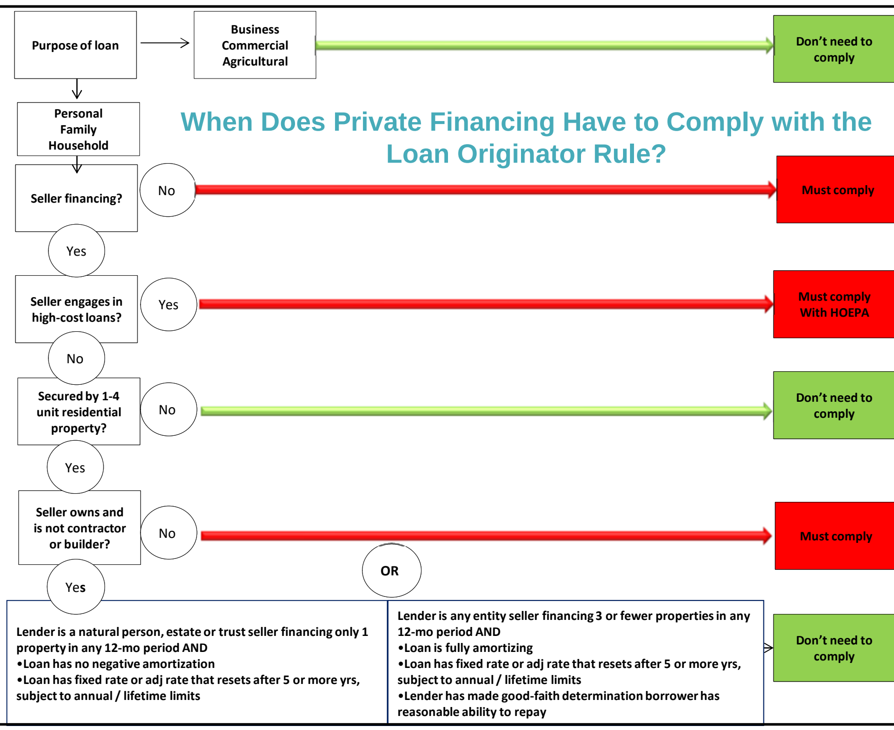
When Does Private Financing Have to Comply with the Loan Originator Rule?



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Questions for the CFPB?

- If you have a question regarding regulatory interpretation, please email

CFPB_reginquiries@cfpb.gov

- with your specific question, including reference to the applicable regulation section(s)
- If you do not have access to the internet, you may leave a voicemail at
- 202-435-7700

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The Loan Originator Rule:

Seller Financing & Private Lending after Dodd-Frank

Thank you for coming!

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Survival Guide to Seller Financing after Dodd-Frank

Seller / financer exclusions from the Loan Originator Rule

1. You are a natural person, estate, or trust & you provide seller financing for only one property in any 12-month period.

- You owned the property securing the financing.
- You did not construct, or act as a contractor for the construction of, a residence on the property in your ordinary course of business.
- The financing cannot adjust for at least 5 years & must not have negative amortization.

2. You are any type of seller financing entity & you finance the sales of three or fewer properties in any 12-month period.

- You owned the property securing the financing.
- You did not construct, or act as a contractor for the construction of, a residence on the property in your ordinary course of business.
- You must have determined in good faith the consumer has a reasonable ability to repay.
- The financing cannot adjust for at least 5 years & must be fully amortizing.
- Just one high-cost loan per year can render you a "creditor," effectively nullifying.

PENALITES: $5,000 per day per violation **/** $25,000 per day for reckless violations **/** $1 million per day for knowing violation.

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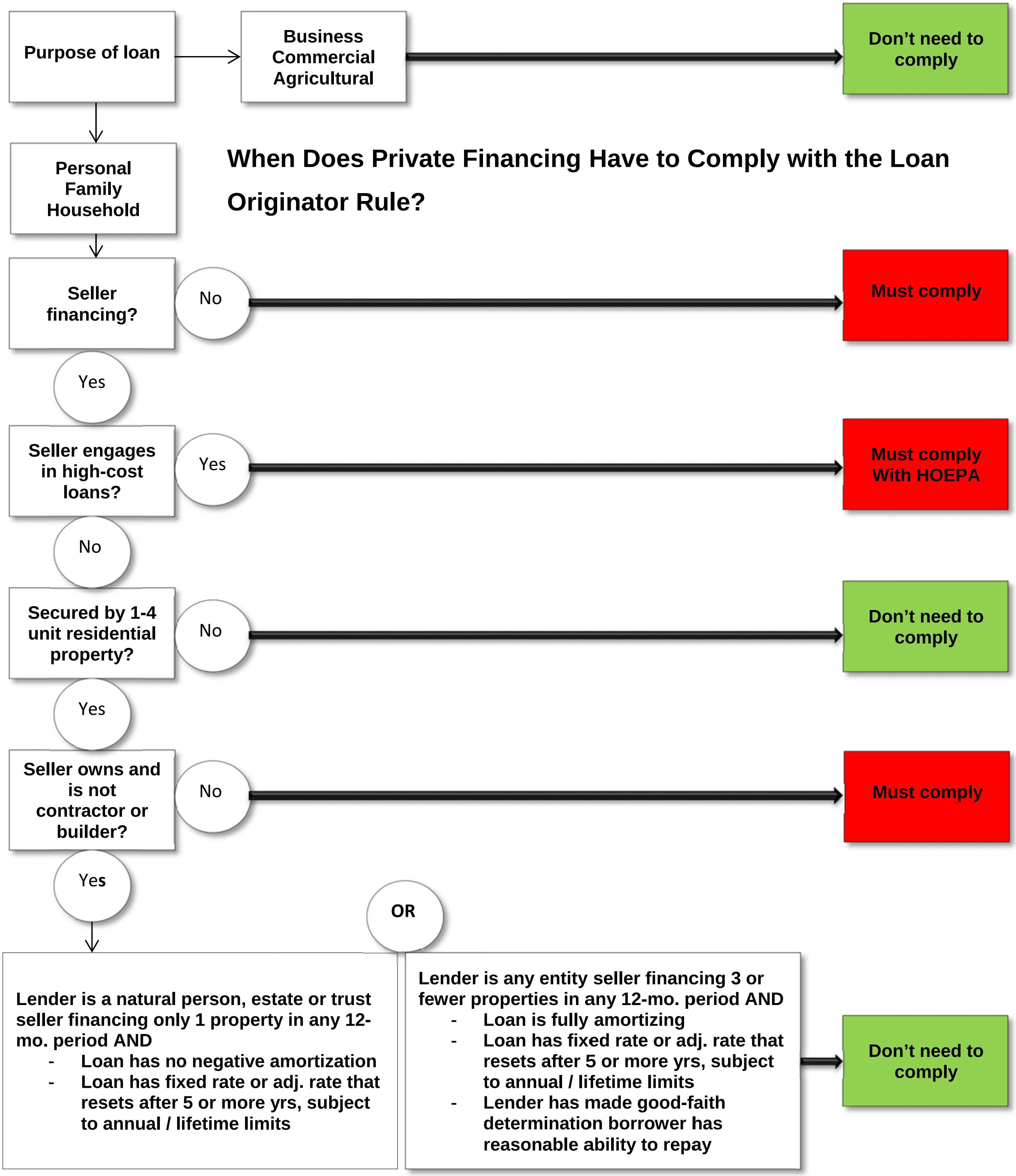
When Does Private Financing Have to Comply with the Loan Originator Rule?



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