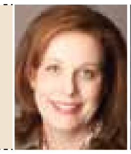


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Trends and Projections for 2014

Use this primer to anticipate and navigate industry developments

This year, the mortgage environment likely will be dominated by Consumer Financial Protection Bureau (CFPB) regulatory guidelines taking effect and the repercussions that may arise from them. As the industry works to interpret and comply with the rules, foreclosures likely will slow, delaying the resolution of the ongoing foreclosure crisis. In addition, the CFPB has indicated clearly that it will use disparate impact for the basis of discrimination cases against banks.

With so many new rules and regulations on the horizon, the practice of originating and servicing mortgages is about to transform in a multitude of ways. It may be impossible to predict exactly what the mortgage industry will look like a year from now, but it can be helpful for mortgage professionals to keep a close eye on certain pieces of legislation and the industry trends that they may instigate. Here's a primer.

Ability to repay

As mortgage brokers and bankers know, the CFPB has produced a new consumer defense to a foreclosure: the ability-to-repay rule. This regulation places a burden on loan originators to determine affirmatively whether an applicant can afford a mortgage loan. The rule requires originators to consider a number of factors, including current income or assets, employment status, credit history, and debt-to-income ratio.

In general, the ability-to-repay rule will force lenders to base their decisions not on whether they believe that the loan will be repaid, but rather on whether a borrower can make a claim in future years that the loan could not be repaid. This likely will alter the way in which brokers and lenders manage their risk and underwriting policies.

Nonqualified mortgages

This month, the long-debated qualified mortgage (QM) rule will go into effect, based largely on the presumption that the borrower has an ability to repay. The QM rule demands a number of loan requirements, including specific debt-to-income ratios, limits on balloon payments and a maximum mortgage duration of 30 years.

Although there's no restriction on issuing non-QM loans, the presence of the ability-to-repay rule is widely expected to make QM status a de facto requirement for securitized loans. There's an open question about whether there will be a market for non-QM loans after this rule takes effect, so that's a subject that every mortgage broker and banker will want to watch.

Disparate impact

The concept of disparate impact has been embraced by the CFPB on the basis of discrimination cases against banks. Essentially, "disparate impact" is defined as any process that has a discriminatory and adverse effect on a given borrower, regardless of intent.

This discrimination standard is complicated by the implementation of the ability-to-repay rule, QM and other lending requirements that may result in accusations of disparate impact. Obviously, disadvantaged minorities likely will bear the burden of tightened lending standards, and so the argument could be made that the very groups the CFPB is seeking to protect also may be unable to afford loans originated in accordance with new standards, thus violating the disparate-impact rule.

The substantial variation in mortgage-application rejections in 2012 — anywhere from 11 percent to 34 percent, according to the Federal Financial Institutions Examination Council — surely will be reviewed for disparate impact. For all the recent scrutiny directed at mortgage banks and brokerages, it seems that a cautious approach to lending would be welcome, but will that approach result in claims and lawsuits related to disparate impact? Only time will tell.

There has been varying analysis in the appellate courts on the application of disparate impact, so the Supreme Court has agreed twice to weigh in and review this legal standard under the Fair Housing Act. The first case, Magner v. Gallagher, was settled in 2012; the second, Mount Holly v. Mt. Holly Gardens Citizens in Action Inc., was settled this past November.

Despite resolutions in these cases, it's imperative for mortgage professionals to understand the disparate-impact standard, as this is the enforcement basis that the U.S. Department of Housing and Urban Development (HUD) and the CFPB likely will use to pursue discrimination cases.

Fair housing

Related to this is the Fair Housing Act, which prohibits discrimination in the sale, rental or financing of dwellings on the

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basis of race, color, religion, sex, disability, familial status or national origin. HUD, which is statutorily charged with the authority and responsibility for interpreting and enforcing the Fair Housing Act, has long used the act to prohibit practices with an unjustified discriminatory effect, regardless of whether there was intent to discriminate.

This past February, HUD issued its final rule for discriminatory-effects standards, including application of disparate impact. The act overlapped with the previously mentioned Mount Holly case, which was centered around the eponymous New Jersey township wishing to designate Mount Holly Gardens as an area for redevelopment. Because the plan included the purchase, demolition and redevelopment of all the homes in the designated area, the town's residents objected to the plans, citing that they would no longer be able to afford to live in the area if the plans were executed.

The residents then filed a lawsuit under the Fair Housing Act seeking to enjoin the redevelopment from moving forward. The federal district court denied the residents' claim, ruling that there was no disparate impact and that there had been a legitimate interest to pursue the redevelopment on the part of the township. The ruling was reversed by the federal circuit court, however, citing that there were further factual elements that the residents should be able to bring into evidence and that there should be alternative means considered for blight removal under the legitimate interest of the township. The township appealed to the Supreme Court, which agreed to review whether or not disparate-impact claims were permitted under the Fair Housing Act as promoted under the new agency rule.

Some of those in favor of the review have argued that there is no private right of action to bring disparate impact claims under the Fair Housing Act and that the new rule and scope of the act doesn't include specific language to bring about disparate-impact claims. Further, they argue that HUD and the CFPB are seeking to overreach and create a cause of action for disparate impact that Congress didn't create or intend. In ruling for the plaintiff in Northwest Airlines Inc. v. Transport Workers in 1981, the Supreme Court mandated that federal agencies simply can't sidestep the constitutional separation of powers with interpretation of congressional intent.

All of this background illustrates one likely trend for this year: Without a clear standard for the application of disparate impact, the CFPB and HUD will move forward enforcing the new ability-to-repay rule, which they claim to be a restatement of existing laws and congressional intent. This enforcement will upset many mortgage companies' basic underwriting criteria and long-standard practices of risk-based lending.

Borrower rights

The concept of "dual tracking" is a novel theory raised by foreclosure defense attorneys in recent years. This is the process by which a servicer negotiates a loan modification while the servicer simultaneously works to complete a foreclosure.

The CFPB has enacted various rules to outlaw this practice. For example, the rules mandate that servicers affirmatively inform borrowers about loss-mitigation options. The rules also forbid the initiation or continuation of foreclosures while loan applications are being reviewed. The CFPB further requires that a borrower is given the reasons for denial of an application. In certain circumstances, borrowers even have a right to appeal the denial of a mortgage loan.

As servicers attempt to comply with these new requirements, 2014 may see the foreclosure process slow dramatically. In addition, it's possible that borrowers will find a means to strategically employ loan-modification procedures and the right to appeal in an attempt to deliberately delay the foreclosure process.

Document retention

The potential that a borrower's ability to repay will be examined years after a loan's origination places a greater emphasis on document retention and a company's ability to justify its decision to originate a loan. Even QM loans are made with only a presumption regarding the ability to repay. In certain circumstances, the same borrowers who pushed to get their loans may be incentivized to later challenge this presumption.

This will create new emphasis to ensure that all origination documents are retained and transferred to the loan purchasers. A failure to maintain loan documents could result in increased repurchase demands.

Resolving the crisis

As the U.S. economy continues its slow recovery, the effects of the foreclosure crisis persist. CoreLogic estimated that there were 939,000 homes in the U.S. foreclosure inventory this past August.

Although this was a year-over-year decrease of 33 percent, the foreclosure crisis isn't over and will continue this year as the country continues to work through its foreclosure backlog. The scope of the remaining crisis generally will vary by state, however. For instance, Florida, Michigan, California, Texas and Georgia accounted for almost half of all foreclosures completed between August 2012 and this past August, according to CoreLogic.

In 2014, banks and mortgage lenders will continue the process of either foreclosing or avoiding foreclosure through loss mitigation. In either scenario, the process will slow as these entities attempt to comply with the new foreclosure rules enacted by the CFPB. Judicial foreclosures and wrongful foreclosure litigation will both be slowed as the courts themselves attempt to interpret and apply all the new CFPB rules in litigation. Undoubtedly, various interpretations of the new rules will be appealed.

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The start of the new year marks a critical time for the mortgage industry. With many new rules and regulations taking effect, mortgage banks and brokerages can expect their businesses to undergo a number of significant changes in the coming months. Keeping an eye on industry trends and ongoing legislation can help you navigate these changes, prepping your organization for continued success in this year and the next. ●