Part Two

How to Combine Your Disclosures

Originators must prepare their businesses for the new disclosure-integration rule that will take effect in August

By Richard Horn

Eight months from now, on Aug. 1, 2015, the final rule integrating the Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) mortgage disclosures will become effective. The Dodd-Frank Wall Street Reform and Consumer Protection Act mandated the Consumer Financial Protection Bureau (CFPB) to integrate these disclosures, a mandate that was a reaction to the financial crisis as well as to the decades of frustration with the current disclosure forms and processes.

The November issue of *Scotsman Guide* presented part one of Richard Horn's two-part series that provides a peek inside the complex machinery of the TILA-RESPA regulations.

Part one of this special series discussed the central details of the TILA-RESPA rule, what loans the rule applies to, who can provide a Loan Estimate, what can be done before providing a Loan Estimate, and when you actually have an application. Part two goes into tolerance requirements, the Closing Disclosure, and important changes to the forms.

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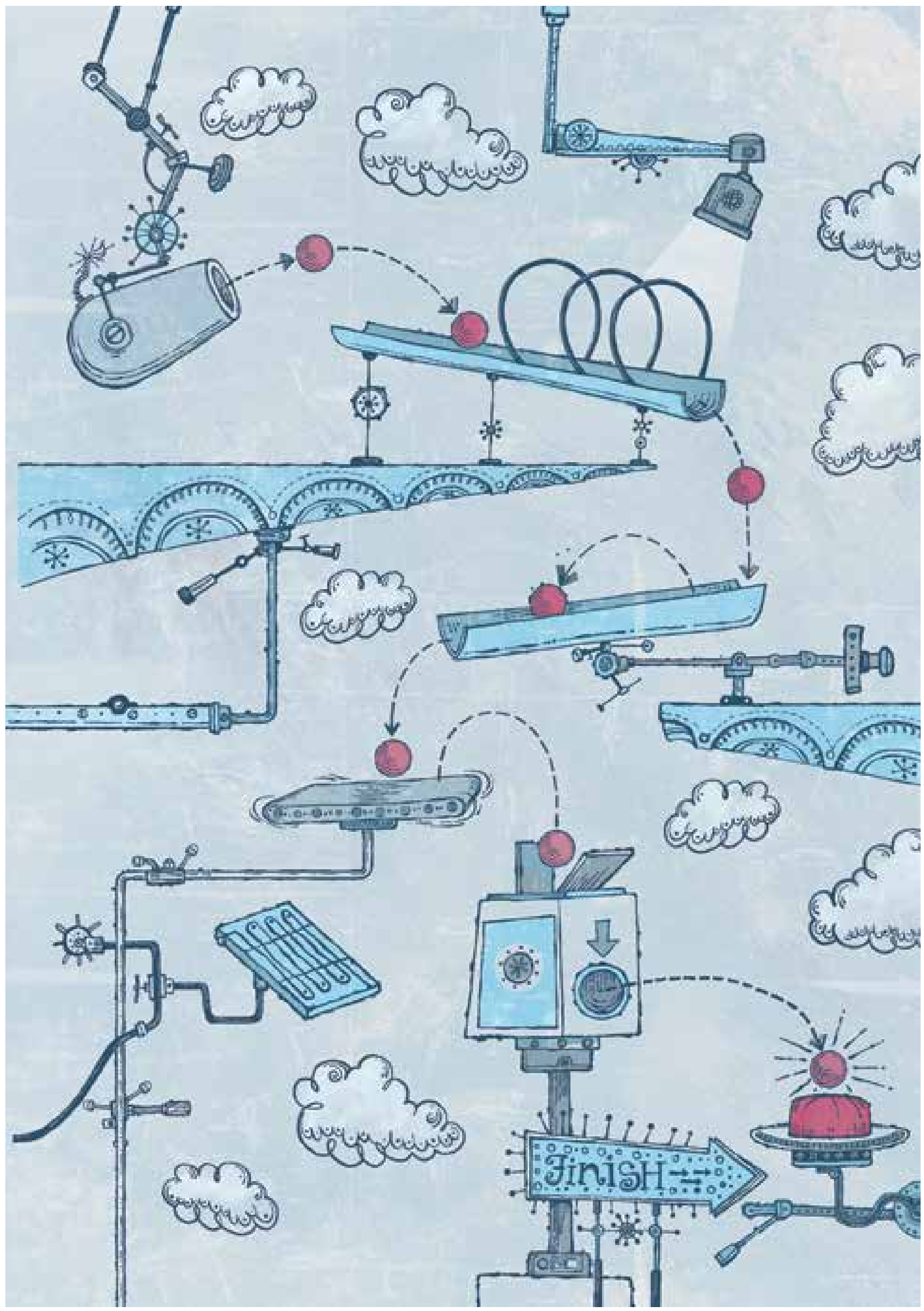

Illustration by Dennis Wunsch

Reprinted from *Scotsman Guide* Residential Edition and **ScotsmanGuide.com**, December 2014

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Tolerance requirements

The new TILA-RESPA rule has similar tolerance requirements as the current rules under RESPA. The rule restricts the amounts certain closing costs can increase from the amounts disclosed on the Loan Estimate, and provides exceptions for "changed circumstances" and borrower-requested changes.

The rule, however, expands the "Zero Tolerance Category" (i.e., costs that cannot increase except under an exception) from the current rule to include:

1. **Charges for third-party services paid** to affiliates of the lender or mortgage broker; and
2. **Charges for which the consumer is not permitted to shop** for a provider.

The "10 Percent Category" is essentially the same except for the charges moved to the Zero Tolerance Category. It includes recording fees and charges for third-party services for which the lender permitted the consumer to shop and the consumer selected from a written list of providers, which is still required under the rule. The sum of these charges may not exceed the total amount disclosed by more than 10 percent.

Charges that are not subject to one of these categories have no tolerance limitations. These charges include prepaid interest, property insurance premiums, and amounts placed into an escrow, impound, reserve or similar account. It also includes service charges when the consumer selected his or her own provider, and charges paid for third-party services not required by the lender. In addition, the CFPB confirmed this past August that this category also includes owner's title insurance when not required by the lender, unlike the current rule where it falls under the 10 Percent Category.

Although these charges are not subject to a specific tolerance, the estimates must still be consistent with the best information reasonably available to the lender at the time they are disclosed. This standard may require lenders and mortgage brokers to attempt to get these estimates from third parties.

Because of the expanded Zero Tolerance Category, which will include charges such as appraisals, you may need to make arrangements with your service providers to get more precise estimates. But you should keep in mind that the rule does not provide an exemption from RESPA section 8, which prohibits payments or kickbacks in exchange for referrals of settlement service business.

If an unlocked interest rate is later locked, lenders are required to issue a revised Loan Estimate on the same day the rate is locked to take advantage of a "changed circumstance" for tolerance purposes. This will pose operational challenges for lenders and mortgage brokers, especially in situations where an interest rate is locked late in the day. The CFPB is looking to ease this restriction slightly with a proposed rule change issued this past October that would give lenders until the following business day after a rate is locked to provide revised disclosures.

The Closing Disclosure

One big change under the TILA-RESPA rule is that lenders are now responsible for the final integrated disclosure form, the Closing Disclosure. This is different from the current rules where the lender is responsible for the final Truth-in-Lending (TIL) disclosure, and the settlement agent is responsible for the HUD-1 Settlement Statement. The new form integrates and replaces these old forms.

The new rule does permit settlement agents to complete and provide the disclosure for the lenders. Just as with Loan Estimates provided by mortgage brokers, however, the lender is ultimately responsible for the Closing Disclosure, so the lender must ensure that the Closing Disclosure is provided in compliance with the rule.

The rule also changes the timing of disclosures. Lenders must ensure that the borrower receives the Closing Disclosure no later than three business days before consummation, which is the point where the buyer becomes contractually obligated to the lender. Consummation commonly occurs at closing, but the timing may vary depending on applicable state laws.

If the Closing Disclosure is not provided to the borrower in person, the borrower is considered to have received the disclosure three business days after it is delivered or placed in the mail or e-mail (typically referred to as the "mailbox rule"). This means that all of the information currently provided on the HUD-1 — including the itemized list of settlement charges — must be provided much earlier in the process. With the mailbox rule taken into account, lenders may have to mail the first Closing Disclosure a full week before closing.

If there are any changes to the information in the three days before consummation, the lender must provide a corrected Closing Disclosure at or before consummation. If one of the following disclosures on the Closing Disclosure becomes inaccurate before consummation, however, the lender is required to provide a corrected Closing Disclosure with an additional three-business day waiting period:

1. **The APR becomes inaccurate,** as defined in 12 C.F.R. § 1026.22;
2. **The loan product changes,** causing the loan product information disclosed on the Closing Disclosure to become inaccurate; or
3. **A prepayment penalty is added.**

If you are the lender, you will have to make sure you have policies and procedures in place to ensure the entire disclosure, including the itemized list of settlement charges, is accurate and provided to the consumer in time for closing. You will have to determine how you will complete the Closing Disclosure, and whether you will continue working with settlement agents. These decisions will be important, because lenders and investors may face borrower lawsuits for violations of the Closing Disclosure requirements.

If you plan to rely on settlement agents to complete the disclosure, you should think about how your software will facilitate the sharing of information and the data formats you will need. For example, how will you make

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changes to the disclosures? Will the settlement agent call you up and read the changes over the phone? Also, will settlement agents provide you with the data for the disclosures in a format you can use for compliance software, investors or examinations by the CFPB or other regulators?

Form changes

Some aspects of the forms will be considered positive changes. Unlike the Good Faith Estimate, which discloses only aggregates for closing costs, the Loan Estimate (discussed in part one of this article) itemizes the settlement charges, including origination charges. The Closing Disclosure also itemizes charges.

The Loan Estimate does not require the disclosure of lender-paid compensation to mortgage brokers, although this is required on the Closing Disclosure. The two disclosures also provide an optional signature line for consumers to confirm receipt. In addition, the Loan Estimate includes the ECOA appraisal notice and the RESPA servicing application disclosure, which will cut down on some paperwork. The Closing Disclosure also incorporates several other disclosures.

The Closing Disclosure lacks a comparison chart that displays the tolerance calculations, however, which means you will have to use a separate worksheet to demonstrate compliance with tolerance requirements. Software will be necessary for this purpose because Loan Estimate rules require rounding of settlement charges, so you will not be able to calculate tolerances by comparing the Loan Estimate and the Closing Disclosure.

One final major change is that the Closing Disclosure does not use the HUD-1 system of three- and four-digit line numbers for settlement charges. Instead, the Closing Disclosure is designed to match the Loan Estimate, using letters and two-digit line numbers. Also, the Closing Disclosure has fewer "hard-coded" lines and requires that most settlement charges be organized in alphabetical order.

Many title companies currently have software that relies on HUD-1 line numbers. This software will need to be revised to work with the new Closing Disclosure. You should also start thinking about training your staff to make them familiar with the new disclosures.

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The TILA-RESPA rule requires significant changes to the way lenders currently do business. This two-part series provides a guide to the major provisions, but as you may expect with a 1,900-page regulation, the rules contain many other changes and new requirements. Considering the lengthy implementation period, lenders should not expect the CFPB — or the plaintiff's bar — to grant a grace period for compliance. So roll up your sleeves and be ready on Aug. 1, 2015. ■